UNITED STATES BANKRUPTCY COURT

SOUTHERN DISTRICT OF NEW YORK

Case No. 08-13555-scc

- x

In the Matter of:

LEHMAN BROTHERS HOLDINGS INC.,

Debtor.

- x

U.S. Bankruptcy Court

One Bowling Green

New York, NY 10004

March 2, 2017

1:34 PM

B E F O R E :

HON SHELLEY C. CHAPMAN

U.S. BANKRUPTCY JUDGE

ECRO: KAREN / RACHEL

Hearing re: Trial on Lehman’s Objection to Claims of QVT (Doc # 17468 Debtors’ One Hundred Fifty-Fifth Omnibus Objection to Claims)

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P R O C E E D I N G S

THE COURT: Welcome back, Dr. Niculescu. How are you?

DR. NICULESCU: Thank you, Your Honor.

THE COURT: You're still under oath.

DR. NICULESCU: Yes, Your Honor.

THE COURT: All right. Mr. Tambe, we're ready when you are.

MR. TAMBE: Good afternoon, Your Honor.

CROSS EXAMINATION OF PETER NICULESCU

BY MR. TAMBE:

Q All right, Dr. Niculescu, let's talk about PCDS.

A Yes, sir.

Q And let's start, as we did, with CARB with just some of the basic structure and mechanics. If you're the protection buyer on a PCDS contract, you have the obligation of making a series of fixed payments, correct?

A Yes, that's correct.

Q And what you hope to earn is a credit protection payment coming your way, if certain events occur, correct?

A That's correct.

Q And those could be either hard defaults, bankruptcies, correct?

A Yes.

Q Or they could be deferrals of dividend payments,

correct?
A Yes.
Q Either one of those would trigger a floating payment back to the buyer of protection, correct?
A That's correct.
Q At inception of the PCDS contracts and the ones at issue in this case, there were no points upfront, correct?
A That is my understanding, yes.
Q There was a running spread?
A Correct.
Q And at inception, the value of each PCDS contract was zero, correct?
A Well by definition, if there's no points upfront then I think that's the definition that you're referring to.
Q Even though on day one there are arguably two cash flow streams that one can calculate, at the inception of the PCDS, correct?
A Yes.
Q One is the payment stream of fixed payments going out, if you're the protection buyer?
A Yes.
Q And the other is the floating rate payment coming back to you, again as the protection buyer?
A Yes. Again, to be -- not to be misleading, you're -- we have to find some probability weight on some potentially

large payment.
Q Right.
A Yes.
Q So there will be -- it'll be probability weighted return stream of a floating payment?
A Yes.
Q And on day one the present value of the outgoing money has to be equal to the present value of the incoming money. That's you want the value is zero, correct?
A Yes. The market's assessment of those two have to be equal.
Q Now, as time goes on the market value for PCDS can change, correct?
A Yes.
Q And one of the things that could cause it to change is an increased probability of a deferral, correct?
A Yes.
Q And if that were to happen the party that's a protection buyer would be in the money, so to speak, right?
A Yes.
Q All right. Well let's take Bear Stearns as an example, okay?
A Yes.
Q So you're in February of 2008 and you had bought protection on Bear Stearns say a year ago, or 18 months

before that.
A Yes.
Q Right? And now Bear Stearns is looking a little precarious in February of 2008, correct?
A Yes.
Q And so you have a big mark to market positive that you're a protection buyer on Bear Stearns, correct?
A I -- I'm not familiar with what actually happened with CDS and Bear Stearns, but I'd see no reason to doubt that.
Q But you do know, from your experience in the market, that Bear Stearns was somewhat distressed in February of 2008, correct?
A Indeed I do, yes.
Q In fact, so distressed that they ultimately got taken over by JPM, correct?
A Correct.
Q Right. And those folks who had brought protection on Bear Stearns, in the hopes of a payout, that when Bear Stearns defaulted they'd get a big payment, they didn't get that big payment, did they, sir?
A No, they did not.
Q Because JPM came in, took over Bear Stearns and the risk of default went down dramatically, correct?
A Correct.
Q Okay. And something similar happened with Merrill

Lynch, right? If you had bought protection on Merrill Lynch, the week before Lehman Weekend, you were probably in the money pretty substantially, correct?

A Correct.

Q All right. And come Monday morning, Bank of America has bought Merrill Lynch the risk of deferral or default has gone down dramatically, correct?

A Indeed, although they had not, in fact, affected a purpose, they made an announcement and the risk had gone down.

Q All right. And so again, if you are sitting, on September 15th, 2008, yes Lehman's gone bankrupt, but there are other data sources available to you, as you're thinking about deferral risk. You have the experience of Fannie and Freddie to think about, right?

A Yes.

Q But you've also got the experience of Merrill Lynch and Bear Stearns to think about, correct?

A Yes.

Q Okay. So just because Fannie and Freddie resulted in a particular outcome where the debt was covered by the U.S. Government but the equity was not, no reason to believe that that's the only scenario in people's minds on September 15th, correct?

A Oh, I quite agree.

Q In fact, again, another differentiating factor between Fannie Mae and Bear Stearns and Merrill Lynch is Merrill and Bear Stearns were not government sponsored entities, but Fannie and Freddie were, correct?

A That's correct.

Q And in fact, the other lesson on the morning of September 15th was unless you get bought by a JP Morgan or a Bank of America, the government's going to let you fail, right?

A That is one lesson people could draw. I wouldn't necessarily say it's the only lesson they could draw.

Q No. But it's in addition to the lesson you discussed with the judge yesterday, which was the Frannie/Freddie lesson, there were a bunch of other lessons that people could have had in their minds on September 15th, 2008?

A I agree.

Q Right. So the Fannie Freddie piece is just one piece of the puzzle. There are lots of other examples and case studies that people could think about, as they thought about deferral and default risk of financial institutions on the morning of September 15th, 2008?

A I agree. I agree.

Q There was a discussion you had I think with the Court yesterday about is there a one for one relationship in the change in price of the preferred security and the value of

PCDS. Do you recall that?
A Yes.
Q And I believe you said there isn't a one to one relationship.
A Not necessarily at all times, no.
Q Is it close to one to one?
A It depends on the price of the preferred, the qualability of the preferred and the term of the PCDS contract.
Q So what's the range? Is it from one to one to say five to one?
A I've seen numbers as low as .4 --
Q Yeah.
A Numbers as high as 1.5. They may range beyond that, I don't recall as I sit here exactly what the range is.
Q But as you sit here, the numbers that came to mind was if it's not a one to one relationship, it could be .4 to 1 or 1 to 1.15?
A Correct.
Q Okay. How about 1 to 100?
A No.
Q 1 to 50?
A No.
Q Not possible, right?
A No.

Q Okay. Now, you would agree with me that if you were simply looking at the price for preferred and trying to value a PCDS, one of the things you have to take into account are the different maturities of the PCDS and the preferred, correct?

A Correct.

Q You'd also have to take into account what the coupon or fixed rates were on the two different instruments, correct?

A Correct.

Q And I think in addition to those two, you also have identified something called a basis risk that you'd have to take into account, correct?

A Correct.

Q And that is additive, that's not another name for what we just talked about?

A No, that's additive.

Q And the basis risk is another disconnect between the underlying the derivative, correct? There's a difference, a differential?

A There's a difference in demand and supply between those two sectors.

Q So for example, the price of the preferred security could be really driven by pure supply and demand as opposed to other macroeconomic factors, correct?

A I'm not sure I understand the question.

Q So. Let's -- yes, (indiscernible). One morning investors could wake up and say, I just don't want preferreds. They may be very attractive, they may have good interest rates, I just don't want anything that says preferred in it. I'm just going to dump it all.

A I suspect you'd find other investors who would want to buy it at that point.

Q Sure. But you could have different investor sentiment being expressed in the price of a preferred security, correct?

A If you're proposing that the markets could be irrational or provide arbitrage opportunities, then I would agree from time to time they can. There are limitations on that. People want to make money and insofar as you present an opportunity that appears to be an attractive investment opportunity, people tend to take that opportunity.

MR. TAMBE: I'm going to have to pause for a second because my real-time is not real-time.

THE COURT: Are we having a problem with the bandwidth today?

COURT REPORTER: No.

THE COURT: Yeah, sure.

MR. TAMBE: Sorry, thank you.

THE COURT: Is anyone else over there having the same problem?

(The Court and Court Reporter confer)
Q So the concept we were just discussing in thinking about the price of the preferred security was the concept of investor sentiment, and you said that could be a factor, correct?
A I don't disagree with the possibility that relative value opportunities or disagreements can open up from time to time. I would say only that they are limited by overall people's intention to try to make money in a market and to pursue those opportunities.
Q Sure. And you could have actually different sectors of investors behaving differently, retail investors as opposed to institutional investors, correct?
A You can.
Q Retail investors are more likely to get spooked?
A I'm not sure if I agree with that.
Q Not something you've studied?
A Well, I have at various points in the past. No, that's not fair. Certainly anybody can buy a retail instrument, you don't have to be a retail investor. The reputation of retail preferred is that they tend to trade at higher prices or lower spreads than institutional preferred. But if the price drops institutional buyers can come in and buy them.
Q So if there were a difference that would get arbitraged away by the institutional investors?

A That at least is the theory.
Q Okay. So let's move from investor sentiment to other factors that might drive the pricing of preferred securities. Certainly deferral risk, correct?
A Yes.
Q But from day to day, if you simply saw a change in the price, the price of a preferred security fell --
A All right.
Q -- from say Friday, just to take an example, Friday, September 12th to Monday, September 15th, one conclusion you might draw is, okay, deferral risk is gone, correct?
A Yes.
Q But you couldn't rule out the default risk had also gone, correct?
A Not if you just observe the preferred in isolation, no.
Q And so to try and isolate deferral risk you would compare the preferred security to another security of the same issuer that didn't have the deferral component, but also had the default component, right?
A Yes.
Q Such as senior debt or sub debt, correct?
A Yes.
Q A few more general questions before we get to Case 1 and Case 2, which is going to be a lot of fun.
A Sorry.

Q So on the general questions, let's talk about the shape of the market, because you spent some time talking about that. So let's go to a slide you used, that was -- that's Exhibit CX-2159 and it's Page 26.

A If somebody has a copy of my hardcopy, that would be helpful.

(Counsel confer)

MR. TAMBE: Sorry Judge, my fault, I should have checked before we (indiscernible).

A Thank you.

MR. TRACEY: Do you have the other materials there?

A I don't have anything here at the moment.

MR. TRACEY: Okay.

MR. TAMBE: So let's make sure you have --

THE COURT: Okay. Let's get you back your binders.

A Do you want me to give that to Mr. Tracey now? Mr. Tracey gave me his copy; I think you can probably give him that one.

(Pause)

Q So yesterday you had discussed for the Court Slide 26 from CX-2159. And this was isolated to the 19 referenced entities, correct?

A Yes.

Q And in fact, if you go to your source document, CX-1788, you'll see that there were -- there was more sales and purchases of PCDS protection by Lehman in the relevant time period, correct?
A Yes.
Q And similarly, if you go to Slide 28 in 2159, again there you focused on the 19 names and you've included, under "Other," about 161 notional. But here you're focusing just on notional purchased by Lehman, correct?
A That's correct.
Q So you're not seeking to identify, in this slide, people who may have brought protection from Lehman, correct?
A That's not the purpose of this slide. I think other slides handle that.
Q All right. And you focused on folks who had sold protection to Lehman, because you were trying to see who else was potentially in a position that Merrill Lynch was in at bankruptcy, correct?
A Well, in part, yes. I wanted to get a picture of the scale and scope of the market, or the transactions, the sources and the uses.
Q Speaking of sources and uses, there was also relevant information on the other side, folks who had been sold protection by Lehman, correct?
A Yes.

Q Because those folks would be in the position of having to value the protection that they had purchased from Lehman, correct?
A Correct.
Q And those would be folks that, perhaps, QVT might want to speak with to see how to value this terribly illiquid product, the sole market maker for which had disappeared, correct?
A I'm not sure whether those folks would have had expertise in valuation or not, or whether QVT should have spoken with them, but I agree that they were on the same side of the market as QVT.
Q Well, at least some of the folks who were on the same side of the market as QVT were large broker dealers, correct?
A I don't recall, right now, to whom all of the people where that Lehman had sold protection. You'll have to remind me of that.
Q You do know, because I think -- were you here for Mr. Neumann's testimony?
A I was not, but I think I -- I've looked at the testimony.
Q You read the transcript? You know the weekend before Lehman filed for bankruptcy, Mr. Neumann and Mr. Chu had some conversations about who's active in the market,

correct?
A Correct.
Q And you were, in fact, shown an email yesterday about folks that the traders at Lehman thought were active in the market, correct?
A That's right.
Q And you said, based on the subpoenaed documents that you'd reviewed, you didn't think any of those dealers were active in the market; is that right?
A That's right.
Q Okay. I just want to be sure about this. So you think the folks at Lehman who were speaking with QVT on September the 14th, 2008 just had it wrong?
A That's -- I'd seen no evidence to support their assertion.
Q Well, the only evidence that you have looked at is the evidence that came back in response to subpoenas, correct?
A I think I've seen an email or two as well, from Mr. Chu on that matter, but I'd have to go back and look at the record to remember that precisely. Certainly the subpoena evidence was a significant part of it.
Q And you don't know, if in response to subpoenas, the major dealers who got the subpoenas simply said, hey Lehman, here's our books and records, come on in, get whatever you want. That's not what that did, is it?

A I would assume not.
Q They gave a limited set of responses, correct?
A My understanding is they would have gone a search on terms such as PCDS.
Q But you don't know what they did?
A Well, I understand that -- what the request was, and I would have every reason to believe the request was fulfilled. I have no reason to believe otherwise.
Q But that was the sum and substance of your investigation was to look at what came back in response to subpoenas, a couple emails that you believe you saw from Mr. Chu and you concluded the traders at Lehman, who identified dealers who were active, as of September 14th, 2018 that was just wrong?
A That's my understanding. As I sit here, that's the best information that I have on that topic.
Q And you know in addition to that email, there were conversations between Mr. Neumann and Mr. Chu about who was active in the market, correct?
A I have no reason to doubt that. I don't recall that specifically, but I have no reason to doubt that.
Q In fact, not just before the bankruptcy filing, but after the bankruptcy filing with Lehman Mr. Chu and Mr. Neumann spoke about this, because Mr. Neumann was going to tell Mr. Chu who else is in the market that Mr. Chu can

speak with, right?
A I wouldn't dispute it.
Q And do you know whether Mr. Chu called any of those dealers and other parties identified by Mr. Neumann?
A My understanding is he called at least one, beyond that I'm -- I don't recall as I sit here.
Q I think you said yesterday that Mr. Chu was trying to replace the PCDS trades. Can you identify a single document under the -- other than the market quotation request sent out by QVT, where QVT attempted to replace the risk it had with Lehman?
A No, as I sit here I cannot.
Q In fact, you did discuss the Merrill Lynch offers, correct? October 1 and October 2?
A Yes.
Q Do you know the story behind those? Do you know whether Mr. Chu saw those?
A My understanding is he did not.
Q Just missed those completely?
A That's what I've been told.
Q So notwithstanding your belief that he was desperate to replace risk, the two -- the only two offers that you're aware of in the maker to sell PCDS protection after September 15, 2008, Mr. Chu missed completely?
A I -- sir, I'm sorry, I didn't express a belief that he

was desperate to replace risk. I'm not informed as to his motivation; I'm simply trying to do a valuation on a replacement trade.

Q So you're trying to do a valuation as if he intended to replace, but you have no knowledge as to whether or not he in fact intended to replace?

A That's not something that I have sought to inform myself about, nor did I consider it relevant to the task I was assigned, which was to compute a reasonable range for a replacement cost.

Q All right. So let's go back to what you have seen and what you -- your slides are based on CS-1788, if we can pull that up. And it's electronic, so.

All right. So you're familiar with this document, right?

A This appears to be the Lehman trade log; is that correct?

Q Right.

A Yes.

Q And yesterday when it came up on the screen it had already been prefiltered, so the only trades we saw on the screen were the Merrill Lynch trades that matched up with the Merrill Lynch offer. Do you remember that?

A Yes, I do.

Q Okay. So this is unfiltered. This is everything on

it, right?
A Yes. I take your word for it.
Q Okay. So one thing we can do is see who else, throughout the history of this blotter, had sold protection to Lehman, correct?
A Yes, one can.
Q And you know how to do that; you know which filter to run, correct?
A Yes, I mean, I think you just -- I don't remember whether it's a P or S field, or what the notionals are, but it's certainly something one can do.
Q But this was part of your analysis, right, that supports the slides that were presented to the Court?
A Yes, it was.
Q So which is the PODS?
A Oh, I don't remember. I -- you asked me -- this was asked to me yesterday and I don't remember. But I'd look it up and we'd determine it.
Q Okay. So hypothetically, let's assume that P is where Lehman has purchased protection from counterparties.
A Okay.
Q Fair assumption?
A I believe that would align with what we saw yesterday on the Merrill Lynch filter.
Q Yeah, but you're not sure?

A As I sit here, I mean, whether it was a P or an S, I'm not going to debate.
Q Well, long or short, it didn't matter, right?
A Of course it mattered.
Q Let's filter for P -- D, column D. All right. So am I right, so that if I filter for P, I find everyone on Merrill's side of the market, at least without doing any other filter, right?
A Again, presuming that my memory is correct and that we're talking about the same thing, we're not playing games, yes, absolutely.
Q No, I don't want to play games. It does matter to me whether you know what P or S is, but we're not playing games.
A Well, and --
Q Let's go down to Merrill Lynch on --
A Fair enough, sir. Fair enough. I mean, purchase or sale and the question in my mind was whether it's from Lehman's perspective or from somebody else's perspective. As I sat here yesterday I didn't remember which one it was, and I think that's a simple matter of fact. I don't think we need to discuss that.
Q Let's confirm.
THE COURT: Now I'm completely unclear. So do you know, as you're sitting here now, having looked at this

again, from whose perspective it is, P or S?
A As I sit here at the moment, I do not. If we scroll to the Merrill Lynch trades I could confirm.
THE COURT: All right.
MR. TAMBE: We're going to do that.
THE COURT: Okay. Okay.
Q Let's go on to Merrill Lynch.
A Right.
Q So you see a lot of Merrill Lynch names there, correct?
A I do.
Q Okay. Does this help inform you as to whether the P is a purchase from Lehman's perspective?
A If we could make one further accommodation and do the filter we did yesterday so I confirm the trades match up, that would be helpful to me.
Q Okay. Sure. Let's go over --
A Filter on the trade date.
Q It's -- actually I think it's --
A Oh, excuse me, the maturity date I think is the right thing to filter on.
Q That's what you want to go to?
A Yeah.
Q Maturity date? So why don't you tell us what to do.
A 2016, March 20th.
Q Does that --

A Very good. They're all Ps, so these are purchases of protection on the part of Merrill Lynch -- on the part of Lehman sales from Merrill Lynch.
Q Okay. So now we've established that we're on the same page.
A Yep.
Q You know what the Ps are?
A Yes.
Q Ps are purchases -- the Ps are purchases of protection by Lehman?
A Correct.
Q Okay. So now that we've got that established, let's go back and see who else sold protection to Lehman.
So let's clear the filters. And now let's just filter Column D for P. And having done that, you'd agree with me, would you not, Dr. Niculescu, that that is a collection of all the counterparties who sold protection to Lehman at some point in time in this blotter, correct?
A Yes.
Q The reason I said "at some point in time" is some of these trades were terminated or unwound before September 2008, correct?
A Yes.
Q You know that?
A I have no reason to doubt it. And I think if we

scrolled to the right we could determine that conclusively, but I would not -- I don't want to waste the Court's time on that point.

Q So let's make sure we're not including in the population folks who may have sold protection to Lehman and unwound it.

A Yeah.

Q Let's see who was around in September 2008.

A Fair enough.

Q So let's go ahead and put that filter on. Let's go to the right and you tell me if I'm getting this right, Dr. Niculescu. Column O, let's just filter it for blanks.

A Okay.

Q So no full termination.

MR. TAMBE: And hold on, Randall, one more.

Q Column M, do we need to do anything there?

A This is a trade assignment date, so the trade was presumably assigned to another party. So again we'd need to do the same filter.

Q So just focus on the blanks. All right. Now let's go all the way to the left. So we've removed from our population any trades that were assigned, correct?

A Yes.

Q And we've removed from our population any trades that were partially or fully terminated, correct?

A Yes. That was correct.
Q Okay. So what's left is the population of counterparties who had sold protection to Lehman on PCDS, correct?
A Are we confident these are all PCDS and there were no debt CDS included here? It says preferred CDS trades as the tab, I presume -- let me make the assumption that's an accurate tab.
Q Well, CDS is in here.
A Yes.
Q And CDS was a preferred CDS, correct?
A A CDS on a preferred security?
Q Yeah.
A Yes.
Q Okay.
A My question was whether there are any CDS on -- debt had appeared in this spreadsheet or not. I'm going to presume that they did not.
Q Well, it's a spreadsheet that you worked with and relied on certainly in preparing your demonstratives, correct?
A Indeed. But I don't remember, on every spreadsheet that I've worked and relied upon, every constituent part. I'm not going to be able to recall that.
Q So let's scroll down this list of counterparties who

were in the same position as Merrill Lynch and had trades that relied on that side of the market in September 2008.

A Yes.

MR. TAMBE: Scroll down slowly. Randall, can you go to the top, please?

Q All right. So you start with AIG CDS, Inc., correct?

A Yes.

Q It's a big institution?

A It was.

Q Let's go down to Alliance Bernstein. Big asset manager, correct?

A My former employer.

Q You got Bank of America in there; do you see that?

A Yes.

Q You got Deutsche Bank AG London?

A Yes.

Q Again, big dealer, sophisticated?

A Whether this is a dealer part of Deutsche Bank or what was it part of, I'm not sure, but yes, Deutsche Bank is a big dealer.

Q And active in the derivatives market, correct?

A Yes, indeed.

Q In fact, that's where the folks at QVT came from, from Deutsche Bank?

A Oh, did they?

Q Is there a question?
A Did they? That was a question. Yes, I wasn't aware.
Q Oh, you didn't know where they came from?
A No.
Q Okay. Well, let's keep going down. Goldman Sachs Capital Markets, dealer?
A I'm familiar with the institution, yes.
Q Good dealer?
A I would hope so.
Q Not in the morality sense of the word, but big dealer.
A Even in the morality sense when I was there.
Q Fair enough. No quarrels here. Goldman Sachs International, same entity, right?
A Related, yes.
Q Dealer, right?
A Yes.
Q Okay. Then you've got the Merrill Lynch. Let's keep going down. Then you've got Toronto Dominion Bank.
A Okay.
Q Smaller dealer, right?
A Yes.
Q Okay. So --
A In London.
Q -- in addition to Merrill Lynch there were other dealers on the same side as Merrill Lynch with live trades

in PCDS facing Lehman at September 15 2008, correct?
A Yes.
Q Okay. Now let's look at the other side of the market.
A Could you do me one small favor before we do that, sir? I'm sorry, it may be out of place and if it is, Your Honor, you'll correct me. Would it be possible to screen out the GSE tickers just to see what is -- the remaining slides of the population?
Q Sure.
A And if that's inappropriate, please -- sorry.
THE COURT: No. It's fine.
Q I'm not sure why we're doing it, but can you do it when Mr. Tracey is asking you questions?
A Sure.
Q Okay. Let's do it then. All right. So now let's look at the other side of the market.
A Yeah.
Q Let's remove the filter for P and go to S. Now, having done that, now we've got folks who are in the same position, economically, as the QVTs of the world; they have bought protection from Lehman --
A Yes.
Q -- correct?
A Yes.
Q All right. Let's take a look at who's on that list.

You got Citibank. Go up. Let's not forget, you got BNP Paribas at the top, right? Dealer?
A Yes.
Q Not big in the U.S. but a big global dealer, right?
A Um hmm. Small position here. Yes.
Q Well, it's not their position here that matters, they're someone who's knowledgeable about securities derivatives, correct?
A I agree.
Q Yeah. Citibank, dealer?
A Yes.
Q Okay. Deutsche Bank -- that's the QVT desk, so let's go down. In addition to the QVT desk you've got the Deutsche Bank AG London there.
A Yes.
Q All right. So you're -- they're both on the buy side and they're on the sell side, correct?
A Yes.
Q Let's keep going down. Hartford Life and (indiscernible) Insurance company, and they've got a number of positions on the same side of the market as QVT, correct?
A That's correct.
Q Not a dealer, but a large financial institution, correct?
A That's correct. Yes.

Q Let's keep going down. You have QVT coming up.
A And a couple of Platinum Groves I saw. Yes.
COURT REPORTER: Could you repeat that?
A And a couple of Platinum Groves I saw. Yes. That's a hedge fund, money manager.
Q Let's keep going. And you got Toronto Dominion Bank on that side as well. Okay?
A Yes.
Q So certainly there were dealers and sophisticated financial institution both on the same side of the market as QVT and on the other side of the market as QVT, correct?
A Correct.
Q I think you testified yesterday that Lehman was the only market marker in PCDS; is that right?
A That's my understanding. Yes, that's correct.
Q Now, one of the names we did not see either in the purchase side or the sell side, when you just went through this list, was JP Morgan Chase.
A That's true.
Q Are you aware of testimony, by Mr. Neumann, that JP Morgan may have been a market marker in PCDS?
A I am aware of the email that was shown to me yesterday that included JP Morgan Chase. What Mr. Neumann said I can't recall as I sit here.
Q But if Mr. Neumann had said that, your view again would

be he was just mistaken?
A Not -- no, I would take what he said at face value and would want to try verify it. My understanding from that attempt at verification is I could find no supporting evidence that they were in fact a dealer.
Q Okay. I mean, helpfully informed, you don't know whether JP Morgan was funded with that dealership, correct?
A No, I don't know that.
Q And nor do we. But you did not make any independent inquiries, independent of this spreadsheet or anything else, to determine whether or not JP Morgan in fact was one of the dealers that had trades on with Lehman as of September 2008?
A Well --
THE COURT: Hold on just a second.
MR. TRACEY: I have an objection, Your Honor.
THE COURT: Yes?
MR. TRACEY: And I think I need to approach, if that's --
THE COURT: Okay.
MR. TRACEY: -- okay?
(Bench conference off the record)
Q All right. Let's move on to another topic.
A Very well.
Q And we'll stop here just briefly that -- I want to discuss one of the graphs in your demonstrative there, which

is Slide 30.
A Yes.
Q And what you're showing here is a comparison between two different indices, correct?
A Yes.
Q And you've got a line there for 9/15/2008, correct?
A Yes.
Q When was it that QVT submitted its calculations there?
A I don't recall exactly. I think perhaps a month afterwards, October of 15 -- I don't -- I don't recall exactly. I'm sure it's in the record.
Q Right. So October 15th would be where on this graph?
A Well, I think you can put it half way between the October 1 and November 1 lines.
Q So just to be clear, and then maybe you can mark it. Do you want a pool cue, so you can just point it out to the judge to where you think that is?
A Presuming it will be approximately here.
Q Right. So it's after that peak that begins sometime in early October, and that peak is over by the middle of October, correct?
A Yes.
Q Okay. And you know that the analysis that QVT did was a backward-looking analysis. They didn't do the valuation on September 15th itself, correct?

A I would assume that they did the valuation some days afterwards. I haven't spoken with them precisely about when the valuation was, but it would be reasonable to think that people were fairly busy on September 15th.

Q And since you don't know when they did it, if I asked you to assume that there's been testimony in this case that they completed their analysis on September 28th, 2008, where would that be on this graph?

A Well, I think you just move over, right before October 1st.

MR. TAMBE: Okay. But if I could just approach?

THE COURT: Go ahead.

Q It would be the bottom there -- somewhere around the bottom of this spike in your graph?

A Presumably, somewhere close to that.

Q Okay. So now we're going to start getting into Case 1 and Case 2. And central to both Case 1 and Case 2 is your methodology and your approach of trying to measure deferral risk, correct?

A I think that's an overstatement. I'm trying to measure the risk of a credit event. My point here, in emphasizing deferral risk, is to note that as preferred stock prices dropped more sharply than bond prices, they did so, at least in part, because of the increase in deferral risk. But my actual analysis is an attempt to find the implied

probability of a credit event implied by the -- in the case of the 13 instruments, implied by the price of the preferred stock.

Q Let's look at Slide 31 in your deck. So I think you described this yesterday. And you use the example of Citigroup and you're showing two dramatically different boxes, right?

A Yes.

Q Let's get back into the fruit salad. Those aren't apples to apples, are they, sir?

A Not precisely because in the first one I have PCDS and CDS and the second one I don't have any traded PCDS levels.

Q All right.

A So I've had to impute the deferral risk from the price of the underlying preferred security in the second box.

Q But -- and the impression -- I believe the opinion you wish to express is that box on the right, the gray box in the right is that much bigger than the gray box on the left because there's a huge amount of deferral risk, right?

A I think as of September 15th the preferred prices had dropped a lot more than the debt prices, implying a significant increase in deferral risk.

Q But --

COURT REPORTER: I didn't hear you.

A I'm sorry, I think --

COURT REPORTER: (Indiscernible).
A A significant increase in deferral risk.
Q But that gray box on the right side, we're going to get to this, is built, it's painted, using your methodology, right?
A Yes, it is. Absolutely.
Q And your curve -- sorry.
A I'm sorry. Absolutely, it is.
Q All right. And that's using your curve construction techniques, correct?
A It is. Absolutely. I want to be clear on that point, this is not a complete third party analysis here. This is a presentation consistent with the analysis I've done elsewhere, and is presented in this document.
Q Except, the gray box on the left doesn't reflect your curve construction analysis; does it, sir?
A No, the gray box on the left did not need to because I had PCDS pricing out for five years.
Q So what if you had actually used your methodology to create a gray box for the transaction on the left? What would that look like?
A I haven't examined that.
Q You haven't examined that?
A No. Because, again, I have PCDS pricing on the left. If I had PCDS pricing on the right I would have used that.

Q Right. But to gauge how good you are at curve construction, it might have been interesting, would it not have been, to go back to a PCDS price and use your methodology to say, what does that gray box look like when I use my curve construction methodology, wouldn't it?
A I appreciate the point, but that's not an exercise I undertook.
Q So comparing those two boxes is not really comparing apples to apples; is it, sir?
A Oh, I think it is. I think that in both cases we're trying to figure out the market implied probability of a credit event and split that probability out between default and deferral risk. I've had to use a different technique, in the second box, because I didn't have data available to me that I would have liked to have had.
Q The question I have for you is, and what we're going to debate this afternoon, is how good is your technique? And you could have tested how good your technique was by going back to a known, observed price and seeing, what does my technique show when I use my technique with a known price, correct?
A I appreciate your point, but I think that the technique is a fairly -- is a standard technique in the market. So I'm simply applying standard methodologies.
Q Well, you don't know what technique was used in coming

with the PCDS price on the left; do you, sir? You just know the price?

A That's correct.

Q So you don't know whether the person that created that price used anything that resembled your curve construction methodology, correct?

A I know that they believed that they had an insight into the market and to supply and demand of the market in that particular moment in time, and that's what informed them and I'm confident on that point. But as to how they accomplished it, I don't have any insight.

Q And you're not aware of anyone else in the market actually constructing curves on PCDS the way you have, correct?

A I don't think that there was a lot of activity in PCDS, so no, I'm not surprised. I don't think -- I'm not aware of anybody else constructing any curves on PCDS during this time.

Q So notwithstanding all that, your view is this is still apples to apples, correct?

A Well, with the proviso that I -- that you have introduced, and that I accept. And that I think I was explicit about in the report, that the boxes on the left are constructed using CDS and PCDS levels and the box on the right, (indiscernible) has to use the underlying preferred

securities.
Q So you got an organic apple on the left, you've got a genetically modified one on the right, right?
THE COURT: That's exactly what I was going to say.
A I can accept that point.
Q Well, the word that comes to mind is frankenfoods, but I won't say that.
THE COURT: No.
Q All right. Let's move on.
A I would disagree with that one.
Q I'm sure you would. I'm sure you would. So let's get -- let's move on to your curve construction, right? So you constructed curves in sort of two different settings, Case 1 and Case 2, correct?
A Yes. I -- well, I constructed -- to be exact, I constructed 19 curves.
Q Right.
A I did it the same way, but I did one for each reference entity.
Q You say you did it the same way, but there was a difference in the data you had for Case 1 versus Case 2, correct?
A Yes.
Q Because in Case 1 you had a PCDS offer and you built

your curves around that offer, correct?
A Correct.
Q In Case 2 you did not have a PCDS offer, you built your curves to fit a particular price, correct?
A Correct.
Q Okay. So you were somewhat more constrained in Case 1 as compared to Case 2, correct?
A No, I'm not -- no, I don't think I was more constrained, I think I had more work to do in Case 2. I had to make adjustments and calculate options and things of that type.
Q Yeah, well it's about six different steps, right?
A Yes.
Q Let me get to Case 1 in your deck. So that's Page 34 at your deck where you have your Case 1, beginning on Page 34. But you proceed that page with a couple of citations, and so let's go to Page 33. And I think you talked briefly about these two publications yesterday, correct?
A Yes.
Q Now, neither of these publications tell you what the shape of your curve is going to be, correct?
A Oh no, that's correct.
Q So these are just basically telling you the basic modeling approach to constructing curves, correct?
A Correct.

Q It's not telling you whether you're going to have a upward sloping curve or a downward sloping curve, right?

A That is correct.

Q And it's not going to tell you whether you're going to have a squiggly curve, right?

A It will not tell you the shape of the curve.

Q This gives you --

A It tells you the technique to construct the curve.

Q It's giving you the basic financial theory behind constructing curves, correct?

A That is correct.

Q Okay. But the curve you actually end up with is based on all the assumptions that you make in taking that finance theory and putting it in practice, correct?

A Yes.

Q Okay. So we get to Case 1 and you've got the six names -- the six name subset from the Merrill Lynch offers; it's Page 34?

A Yes.

Q And all you get from Merrill Lynch and those offers, with respect to these six names, is a maturity date, the name of the referenced entity, the spread and then, as a cross reference, the lower Tier 2 CDS spreads, correct?

A Correct. Yes.

Q Merrill didn't send along, with its offers, a curve?

A They did not.
Q You got points in time, correct?
A Correct.
Q Okay. And so let's go to the next page, Page 35. And the case if two of the transactions, or two of the names, the points in time you got from Merrill Lynch were exactly the points in time that QVT wanted them, correct?
A Correct.
Q So there what you did, and that's RBS, you simply took the 750 basis points and you got the value?
A Correct.
Q You didn't construct a curve?
A No.
Q No shape? Right? It didn't matter to you?
A No. Didn't matter. I could have done so, but there was no need to.
Q Okay. And the same thing with UBS, straight, correct?
A Correct.
Q Now, for the other four names, all you had was a point in time, and that point in time didn't line up with the QVT point in time, correct?
A Correct.
Q So you had to construct your curve?
A I did have to.
Q So let's build a curve. So it's 5987.

THE COURT: Should I take out a colored pen?
Q Well, you're going to tell us, Dr. Niculescu, how you value the PCDS depends on how you construct the curve, right?
A That's -- that is correct.
Q Right? That's what drives your valuation, correct?
A That's correct.
Q Okay. So let's be sure we get this curve construction right and we understand exactly what you did to construct your curve.
A Certainly.
Q Right. Okay. So what you got from Merrill wasn't a curve, you got a dot?
A That's correct.
Q Okay. And that's 7 1/2 years out, correct?
A That's right.
Q And you want to try and value something that's a lot shorter dated than that?
A About 4 1/2 years, I think.
Q Okay. So that's the dots you got and what you ended up with is your Slide 36. Maybe we can have both up at the same time. That would be great. So your Slide 36 shows that the dot is right on your curve, correct?
A That's right.
Q And that's not because you're particularly good at

curve construction, you constructed your curve around the dot, correct?

A That's correct.

Q Okay.

A I used the dot as an input. I'm taking that price as a valid market price.

Q So and you knew nothing about Merrill Lynch's curve, correct?

A I had no other information about Merrill Lynch beyond the quote that was given as we just discussed.

Q So for all you know, Merrill Lynch, if it had a PCDS curve, had a curve that just went straight out at 750, correct?

A Well, no. As I've given my opinion yesterday, I think that a reasonable market participant at the time would have expected there to be a front loading of deferral risk here and so would have constructed a curve that reflected that.

Q I'm not asking for your opinion, I'm asking for what you know. As far as you know, Merrill Lynch could have had a flat curve, correct?

A I know nothing about what curve Merrill Lynch itself could have had.

Q And Merrill Lynch could have had an upward sloping curve, correct, as far as you know?

A Again, I know nothing about what Merrill Lynch could

have had, and in answer to your question about knowing as opposed to supposing, the answer has to be yes, but with my earlier proviso so as that answer is not misleading.

Q But the curve you constructed is higher than the Merrill Lynch point up until the Merrill Lynch point, correct?

A Yes.

Q And all other things being equal, having that curve be higher than the Merrill Lynch point, you're increasing the value of PCDS -- of the PCDS in QVT's claim, correct?

A That is -- the value goes up slightly, yes.

Q And in fact, if you just -- and so assuming it was a downward sloping curve, that it was just a flat level of 750, you'd come up with the lower valuation, correct?

A Yes.

Q And if you assumed it was actually an upward sloping curve, you'd come up with an even lower valuation, correct?

A That is correct.

Q So the line you drew is based on a whole bunch of assumptions about what a referenced market maker, where a market marker in September 2008, end of September 2008, would have done and would have thought about the curve for PCDS, correct?

A Yes, that is correct.

Q But you haven't spoken to Merrill Lynch that put this

offer out, correct?
A I have not had that opportunity, no.
Q Did you ask the folks at QVT to subpoena Merrill Lynch on your behalf and get more information about this stock?
A No, I don't believe anybody has subpoenaed Merrill Lynch in this respect, neither Hogan Lovells nor Jones Day. In my experience it's usually not very profitable to ask people what they were thinking, that long ago in the past, about a quotation they may have given. But no, to my knowledge nothing of that type has happened.
Q Now, you talked about some of the theory underlying why you constructed the curve the way you did, correct?
A Yes.
Q And what you said is, well, you assumed that the financial crisis would not last forever, correct?
A Yes.
Q And you said, well therefore the risk will change over time, correct?
A Yes.
Q And so what you tried to do was try and figure out what curve would fit your views of the financial crisis, correct?
A What curve would fit the curves that I am of the opinion a reasonable market marker would have had at the time, correct?
A But the views you were pulling together were not in

October 2008, right?
A I -- sorry, can you ask the question again? I'm not --
Q You're --
A -- sure I understand.
Q -- sitting at your work station with all the folks from CMRA behind you --
A Yes.
Q -- sometime in 2014 or 2015, trying to construct this curve, correct?
A Yes.
Q And you're looking back and you know how long the crisis has lasted?
A Well, indeed. I would have had a much more abrupt change in the curve if I had wanted to really follow the actual trajectory of the crisis.
Q But you didn't --
A It would have been steeper and then would have come -- reverted much more quickly. But certainly I do have hindsight. I was trying very hard to make sure that I could put myself into the shoes of somebody sitting there on September 15th, 2008 with the information they had available, with the market commentary I could find from that time as my assistance constructing these curves.
Q And now --
A But I take your point, one has hindsight. You have to

try to distance yourself, if at all possible, from that hindsight, that's what I attempted to do.
Q Part of your hindsight, and part of your analysis was that in the long term, from your five onward, the differential between deferral risk and default risk would be fixed; is that right?
A That is correct.
Q Okay. And you used that assumption in this model, correct?
A I used that assumption in this model.
Q Okay. So again, so we start off with one dot, but now you've got another constraint that you're adding in as an assumption, correct?
A Yes. That's one of the two primary assumptions I need to make in order to develop this curve. I need to have some fixed point on a long term.
Q Right. So again I think what you're trying to hypothetically say is a dealer sitting back in 2008 would say at five years from now there's going to be this equilibrium, correct?
A Situation normal, yes.
Q And that equilibrium, in your view, is going to continue till the end of time, correct?
A Yes. That's the projection, is that we continue to have a ratio of preferred to debt that was stable, as it had

been prior to this crisis.

Q And that point is some point lower than the dot you have that you started with in the example of Barclays, correct?

A Yes. Just to be clear, what you're seeing on Page 36 is a spread curve --

Q Right.

A -- which is ultimately the curve that gets put into the calculator. Underlying the spread curve is a hazard rate curve. The spread curve, to be clear to the Court, shows the incremental spread from Year 0 through the number of years on the page. So for five years, for example, it's slightly more than 800 basis points.

Underlying this, there's a hazard rate curve, that is the incremental probability of loss for each year, one year after the other. So that the hazard rate curve will be lower than the spread curve, when the spread curve is downward sloping, like this.

Q But was that not an important curve to show the judge when you put your demonstratives together?

A Well, I think that the -- I'd be happy to provide it. I think that the ultimate curve that I wanted to show was the curve that is used to generate the CDS valuation, which is what I've shown here.

Q Okay. So maybe I'm mistaken. This is the ultimate

curve you used to show the CDS valuation?
A Correct. Yes.
Q Okay.
A The hazard rate curve is used to build this curve. This curve is what we're going to the calculator to calculate the CDS value.
Q And your hazard rate curve, you got the hazard rate, if I'm using the term correctly --
A Um hmm.
Q -- fixed from your five onward, correct?
A That's correct.
Q And it's fixed at ten percent above the senior CDS rate, correct?
A Adjusted for recovery rates, yes.
Q Adjusted for recovery?
A That's to say the hazard rate is the loss rate, so I shouldn't say just for recovery rates, yes, the hazard rate is ten percent higher.
Q Okay. And having constructed the Barclays curve, you know that that five year onward rate, which is a fixed rate in your model --
A Yes.
Q -- would be a number or a line lower than the dot, correct?
A Yes.

Q How much lower than the dot?
A No, I don't recall. I'd have to go back to my spreadsheet. But --
Q Which spreadsheet?
A The ones that generated this that I provided to Lehman.
Q So we may go there.
A Very good.
Q But it's some line below the dot, right?
A Yes.
Q I'm going to try this to see if we can --
A Please.
Q -- (indiscernible).
MR. TAMBE: I don't know what color this is, Judge, but we'll try. So -- and this is demonstrative only, right?
A Fair enough. I take your point.
Q We're starting at year five somewhere.
A Yeah.
Q We'll put a dot here. And let's assume that this goes out, right?
A Yes.
Q That's in your hazard model. And this is before you build the ultimate curve you're working with, you make an assumption starting in year five there's going to be this straight line which is 1.1 times the senior CDS, correct?

A That -- the senior CDS hazard rate. Yes, that's correct. Yes.

Q Okay. And I still --

A I'm just simply taking market implied loss data from the debt market, which was relatively liquid the five year and on, debt CDS market was relatively liquid.

Q Okay. Let's be clear, you're doing two different things there, sir?

A Yeah.

Q You're making an assumption that from Year 5 onward, that there's going to be this fixed rate 1.1 times the senior CDS rate, correct?

A The senior CDS hazard rate, yes.

Q And the senior CDS hazard rate is something you can observe, correct?

A Yes.

Q So you said, from year 5 onward, I'm just going to assume that's fixed, correct?

A Correct.

Q Now, what if sitting in Year 0, right, that's where the dealer is sitting?

A Yeah.

Q The dealer says, you know what, there's some such thing known as a business cycle, maybe seven years from now, it ain't going to be smooth sailing, there's going to be risk

seven years from now. Possible, right?
A Incremental deferral risk.
Q Incremental deferral risk, possible, correct?
A Certainly. Or you could simply increase the ten percent if you wished.
Q But as you raise this line, correct, you go higher and higher on this five year out line, then you've got a balance for that. The early part of your curve has to go to come down, correct?
A Correct.
Q Right.
A Yes, as -- absolutely. I want to make sure this is clear, and I'm in full agreement with you. There are two major assumptions here and the backend assumption is one of those assumptions.
Q Right. And that backend assumption is an assumption you make not based on any empirical data, right?
A No, it based on empirical data.
Q That once you look beyond five years, business cycles go away?
A No, no. I'm simply going back to the ratio of PCDS to CDS in the first half of 2008; that's my empirical data.
Q But that's a point in time, right? The first half of 2008 was a period in time. You're saying that that relationship of 1.1 is going to begin in year five and just

going to last forever?
A That's correct, yes.
Q Well, you don't have any empirical basis to say that that relationship had lasted at that level, unchanged forever; do you, sir?
A No, no. I mean, nor could one. There is no such data. But you have to make a reasonable assumption. I mean, we can argue with the assumption, whether it should be 10 percent, or 12 percent, or 15 percent, or 8 percent. There is going to be some -- you have to make some sort of increment to long term debt hazard rates. And the question is really how high can or should you think deferral risk would be in the future.
Q But you pegged it at 1.1 --
A Yes.
Q -- and if you pegged it at 1.2 or 1.3, your valuations would have been lower, correct?
A That is correct. Yes.
Q And no empirical data that you relied on, to say it's got to 1.1 over the long term, or 1.2 over the long term, correct?
A Well, long term empirical data doesn't exist, therefore we have to use the data that is available to us.
Q Right. But again, this methodology, where you have to use the data that's available to you, that's your

methodology, correct?
A Well, of course. I was asked to do a valuation, so I've used my methodology. I've developed a methodology, but my point is anybody who develops a methodology of this type has to make some assumption here. I'm making what I believe to be a defensible assumption.
Q Well, you know I'd question the defensibility of that assumption, because that assumption is assuming it's at 1.1 flat all the way out, correct?
A Yes, sir, it is.
Q And you would agree with me that we didn't eradicate business cycles in September 2008, correct?
A I agree that there could be incremental deferral risk at various points in the future, but I think that it's a reasonable and defensible assumption.
Q So let's go back to that point, right? So you say it's a reasonable defensible assumption. I think you'd said before that you'd tried to use a scientific method to your approach here.
A I don't recall if I used the word scientific or not, but I certainly tried to use a rigorous approach.
Q Is it not a scientific approach?
A People use the science in many different contexts and ways. I -- as a financial economist and a recovering macroeconomist, I'm not sure I'd apply the word science to

all of these concepts.
Q So let's go to your transcript -- deposition transcript.
A Very good.
Q Page 342.
A And if I used it there, then I used it there.
Q It's kind of important, Professor.
A Is it?
Q Dr. Niculescu.
A Thank you.
Q Sorry. I shouldn't make you a professor.
A Please don't do that to me.
Q It's kind of important though, isn't it? Where you're using a scientific method or not? Those words matter; don't they, sir?
A I didn't intend them to matter if I used them, no. what I intend to say is that I am using a rigorous analytical model based approach. If that appears to be science to some people, so well and good.
Q Well, I'm not the one who said it was science, you did. Let's go to Page 342 of your transcript.
MAN: The second line.
Q Second line. Okay. So 341, that's where the question begins. And I can't read that, so. I think -- so question starting on Page 341, Line 20.

"I think the phrase you used -- I think -- I have, I think done better, so qualitatively between simply using the prices for doing what you've done, such is calculating the implied losses, you think calculating implied losses is the better methodology?"

On Page 342, Line 3, "I think it's the more sophisticated methodology. Now whether something is better or not ultimately in these circumstances, comes down to what a counterparty is prepared to pay. What I've done here is a financed theoretic approach. One might characterize it as a scientific approach, using as much of the data as I can find available. Having said that, I still have assumptions that have to be made about how a reasonable actor would perform in this space." And I'm going to stop it there, but that's the phrase I was referring to. Your statement that one might characterize what you have done as a scientific approach.

You didn't follow a scientific approach, did you, sir?

A In fact what I said here I think is quite accurate, and I'm glad that we reviewed it. I said one might characterize it as a scientific approach. I agree, one might, many might. And I go on to say, having said that, I still have assumptions that have to be made about how a reasonable actor would perform in this space. So I think these two

sentences taken together accurately convey the intent I was trying to convey in the deposition, and the same intent I'm trying to convey here today.

Q Which is, unlike a scientific approach, which might be subject to peer review by others, your methodology and your assumptions are only subject to review in this court, correct?

A Oh, I welcome review from Lehman. I'm sure I'll get it. No --

Q You're getting it right now.

A -- a scientific approach -- a scientific approach does not imply everywhere and always that there was peer review. The scientific method and philosophy does not require that either, it requires, primarily, a process of conjecture and reputation. Conjecture as to the type of approach you may use and examination of the results that approach creates, develops. And a question as to whether those results are reasonable or not. And indeed I've done exactly that. I've conjected as to an approach that might be used. I've calculated the results, I've compared those results with what I think a reasonable person might have done at the time. I've observed the spread curve that's downward sloping, but not terrible downward sloping. And so I conclude that on that basis of the -- I have performed or conject and reputation, it seems to pass the first

reasonableness test.

Now, of course I have to make assumptions. And indeed, although I don't profess to be a scientist, scientists have to make assumptions as well.

Q So just to answer my question, you did not submit your methodology and your curve construction and the shape of your curve for peer review by scientists and economists, correct?

A Correct.

Q Okay. And different people, using the same building blocks of curve construction, might come up with curves that look very different, correct, than yours?

A I would be curious to see just how different they would be. I think that the major assumptions I have made here are well within the bounds of reasons, so I would be somewhat surprised to see results that varied substantially from the results that I've generated here. But if you have evidence to the contrary, I'd be very happy to look at it.

Q One of the things you might discover, had you submitted your -- the application of your methodology to data is that people differed with your application of your methodology to the actual data, correct?

A I have no particular information on that score.

Q And again, going back to the curve construction point, if someone were to use the same building blocks as you, but

construct a flat curve, that would be a lower valuation, correct?

A Yes, it would be, indisputably.

Q And if someone constructed an upward sloping curve, that would be an even lower valuation, correct?

A Indisputably, it would be a lower valuation.

Q And others still might say, we're not going to do all of this curve construction stuff. I'm just going to look at the change in price of preferred securities from 9/12 to 9/15 and based my analysis on that change in the value, correct?

A One could a lot of things. One could take the difference from par and -- to preferred price. One could look at the -- you could do a lot of different things that might be reasonable.

Q Now, in terms of testing how reasonable your assumptions were, we know you didn't go back to the July 2008 price observation to see how your theory fit that price observation, correct?

A That is correct; I did not.

Q And in fact, you didn't do that with respect to any prior observed PCDS transaction, correct?

A No, that is correct.

Q Let's go back to the diagram, because we started talking about one additional assumption you've made, this is

Exhibit 5987.
A Yes.
Q So you start with a dot, the next assumption is from year five onward you're going to have this fixed spread?
A Yes.
Q Now you've got to make some assumption about the first five years, correct?
A That's right.
Q And the model you end up with, the curve you end up with, in the first two years, is higher than the next three years, correct?
A That's correct.
Q What's the assumption that underlies that?
A The assumption is that the financial crisis would be front loaded, would reach and stay at its peak for two years, would then drop in intensity for the following three years, and then revert to a normal long term equilibrium.
Q Right. So at the end of two years it would drop in intensity. You put a number behind that, right?
A Yes, I did.
Q It would drop in half?
A The increment over the long term would drop by half.
Q Okay. So I'm going to draw --
A Please.
Q -- on this 5987. For the first two years you've got

something high up there?
A Yeah.
Q And then the half it drops by is the distance between that upper line and that lower line, correct?
A Correct.
Q That's what you mean by half?
A Correct.
Q You pick the halfway point and you say there --
A Yeah, a bit higher. Yeah.
Q Is that good?
A Yeah, it looks good. Surely, sir.
Q All right. In terms of your assumptions, that's the stair step we built, correct?
A That's correct.
Q Now, you're valuing transactions that are what, about 4.4 years out on average?
A That's right.
Q And what you have done is you have this higher spread now, in the first 4.4 years, correct?
A That's right.
Q And that's based entirely on your assumptions as to what happens from Year 5 onward and what's going to happen from Year 2 to Year 3, correct?
A That is correct. Those are the pivotal assumption that I've had to make. Yes.

Q And then, because that doesn't look like what you showed the judge, because what you showed the judge was a smooth line, not a stair step. Let's go there, 36.

MR. TAMBE: If you can put 36 on the demonstrative up.

FEMALE: I don't think we can, because the demonstrative (indiscernible).

MR. TAMBE: Oh, we can't? Sorry. Okay. Can't do that.

Q So we will just look at the demonstrative 36. All right? That's a smooth line, right?

A Yes.

Q And you create that smooth line by sort of filling in the points and you get a smooth line from Point A to the end, correct?

A Not exactly. The smooth line is the accumulation of these points. So as you go out you get part of the hazard rate from the first two years still affects the results, but in Year 3 you also get the hazard rate from Year 2 to 3 of that kind of spread and so the spread is a little bit lower, and as you go further out the spread gets lower and lower.

But I mean, to your point here, Mr. Tambe, the hazard rate function is quite clean and quite simple. And as you've drawn a midway point, I can't vouch for its accuracy, that looks as though it's actually close to the

700 basis points on this drawing, I don't know whether it is or not. But I think the point is that there is some hazard rate function that underlies the Merrill Lynch spread quote. I'm presuming that it is going to be somewhat lower than that spread quote from five years on out, and therefore, somewhat higher, at least in the early part.

Now it may be actually similar for Years 2, 3 and 4. But on average it will be higher. And I think it's the average that's important to understand in the course, because it's the average that causes the valuation, it's the average spread of 4 1/2 years that is what generates the valuation. So I'm sort of looking at that average spread, versus the average spread for 7 1/2 years is what's key here in the valuation context.

Q Why don't you turn in your slide deck back to 30.

A To 30?

Q Please.

MR. TAMBE: Sorry, Randall, keep the demonstrative up.

A Yes, sir.

Q So Slide 30 is where you're showing this difference between preferred yield spread to debt, correct?

A Yes.

Q So someone sitting, on 9/15, sees the spread increase tremendously, correct?

A Correct.
Q Doesn't know whether it's going to stay at that increased level for a week, a month, two years, five years, ten years, correct?
A That's why we do valuations as of a certain date. That's right.
Q Well, then you get to October 1, 2008 and now the spread differential is down dramatically.
A Yes, indeed. Debt spreads widen substantially as preferred spreads did not widen as much. So you saw the spread narrowing as debt spreads increased. Yes.
Q All right. So someone sitting there might have a very different view of how long a crisis was going to last, whether it was going to last for a week, a month, a year, two years, five years or forever?
A Oh, certainly the analysis can change from time to time, there's no doubt about that.
Q And someone sitting at October 15 submitting a $383 million valuation to the Lehman estate might have a different view of what's going to happen to preferred securities over the next week, month, five years, ten years, correct?
A Indeed. I'm -- I was asked to do a valuation as of September 15th, which I understand to be the relevant date, so that's what I've attempted to do. But I absolutely agree

that people's evaluations will change from week to week and month to month.

Q Okay. All you're doing here in your curve construction is using these basic building blocks, that is in Case 1 you start with a dot from Merrill Lynch, you then add the assumption about what happened from Year 5 onward, you add the assumption about the two years versus the latter three years, correct?

A Yes, I do.

Q And then you create a curve, correct?

A That is correct. Yes.

Q Now, if (indiscernible) assumed that there would be a short heightened period of spreads and then it would turn back normally within a year, evaluations might be lower, correct?

A They might be higher. I would want to run the valuation. I mean, it's the -- if -- I'm sorry, they might be higher. I would want to run the valuation. If you credit the 700 basis point spread of 7 1/2 years, but you truly believed that all of the risk was in the next one to two years, all of the incremental preferred risk was in the next one to two years, and that they -- then the risk followed the risk of the debt implied default, then you would tremendously front load that incremental preferred risk.

Q So one of the things you didn't use in Case 1 is you did not look at the prices of the preferred securities of these six names, correct?
A No, I did not.
Q Right. Because the prices of the preferred securities would give you another data point that you could use to check whether your curve construction was correct or not.
A Not necessarily. I disagree --
Q Can I just stop you there for a second?
A -- with that point.
Q You disagree with that point?
A Yes.
Q Okay. But in Case 2 all you had -- you didn't have a dot, all you had were the prices of the preferred securities, correct?
A Correct.
Q Okay. But you did have prices for preferred securities in these six names in Case 1, correct?
A Yes. They are available. I didn't examine them.
Q So you didn't do that cross check to say, okay, when I don't have the price and all I have is the spread from Merrill Lynch, do my methods line up, correct?
A Yes. I -- and the reason is because, as you've asked, what was it that Merrill Lynch did, I don't know what Merrill Lynch did. I don't know what they were -- what

method they used or how they were approaching it. And so I simply want to use, and did use, the Merrill Lynch quotes.

Q So as we move from Case 1 to Case 2 --

THE COURT: Before --

MR. TAMBE: Yeah?

THE COURT: -- you move from Case 1 to Case 2, we've just been at it for about an hour and 20 minutes.

MR. TAMBE: Sure.

THE COURT: Is this a good time --

MR. TAMBE: Yeah, absolutely.

THE COURT: -- to take a break?

MR. TAMBE: Yes.

THE COURT: Because when we come back it'll be a segment that gets us to the end of our day together.

MR. TAMBE: Sure.

THE COURT: All right? Yes.

MR. TAMBE: And just for recordkeeping --

THE COURT: I'm sorry?

MR. TAMBE: That's fine. For recordkeeping, what I'll do is mark as --

THE COURT: Yes.

MR. TAMBE: -- if it's helpful to the Court, mark what I've written on as Exhibit 5987-A and provide copies --

THE COURT: Perfect.

MR. TAMBE: -- to the other side and to Your

Honor.

THE COURT: Okay. Great. All right. Let's come back at 3 o'clock and we'll continue till 4:30.

(Recess)

THE COURT: Oh, we've taken our jackets off. Excellent.

MR. TAMBE: Thank you, Your Honor.

Q Dr. Niculescu --

A Yes, Mr. Tambe.

Q -- just before we leave Case 1, I just want to finish up on Case 1. One of the calculations you do is you extrapolate, and I forget the term you used yesterday, heuristic calculation to go from the six names to the population, correct?

A Yes.

Q All right. I don't -- I confess, I don't know what that word means, but that's the calculation you did, right?

A I'm sure Google can tell you.

Q Okay. All right. So -- I don't trust Google. Page 37 of your demonstrative, so that's your calculation -- so let's just set the stage here. That's the number you arrived at when you start with the Merrill Lynch offer, correct?

A Yes.

Q And that's for four of the names, you do your curve

construction?
A Yes.
Q Right? And that gives you the valuations you see in the second to last column on the right, correct?
A Correct.
Q And you apply it to the notionals of each position and you come up with a $29.6 million number, correct?
A Yes.
Q Right. So that's your Case 1 valuation for those six names. And then what you do, I think, towards the end of the demonstrative deck, is you've extrapolated that to the population, to all 19 names, correct?
A That is -- the other 13, yes.
Q Sorry, the other 13. So that's on Slide 30 -- 49. And what you call the Merrill floor is $89 million, correct?
A Yes.
Q And so just rough orders of magnitude, to go from the six names to the other 13, and the $89 million is for all 19 names now, correct?
A That is for all 19 names.
Q That's the population?
A That's the population.
Q Apples to apples, these lines are all apples to apples in your world, correct?
A Within the provisos we've made, yes.

Q Right. So it's roughly you go from 29.6 to 89, was about three times?

A Yes.

Q Okay. And all you're doing there is looking at the notional size and saying, I was valuing a notional that was one-third the total, I'm going to apply that same to the full population?

A I think the numbers were of the order of 123 million notional for the Merrill names, and 371 million total. So, exactly right.

Q Okay. All right. So let's go back to 37 then. If you were to assume that you know nothing about the Merrill curve, and that the conservative thing to do here is just take a flat line, you could have run that calculation?

A Yes, I could have.

Q So just, again, to be clear on, say, Barclays, where they -- the dot you have is at 700 basis points, instead of creating that downward sloping curve, if you just said, it's 700 all the way through, you could have calculated a valuation both in percentage of notional terms and dollar terms, correct?

A Correct.

Q And directionally you know that if you had done that for every line that you create a curve, you'd come up with a number that is lower than your 29.6 number, correct?

A Yes. For the four names it would be lower, and therefore for the 29.6 total it would be lower, yes.
Q Do you know how much lower, sir?
A I don't recall if I know that number.
Q Okay. I've tried to do that calculation --
A Okay.
Q -- I'm going to show you the number and see if that jogs your memory.
A Very good.
Q Now fair warning and prefatory remarks. You've got to go to Bloomberg to do those calculations, correct?
A Yes, you do.
Q Okay. So you can't just do those on your calculator?
A No.
Q This is 5985. Okay. Because what you did is -- the curve you took, you took your curve to Bloomberg's CDS calculator and had Bloomberg calculate the number for you, correct?
A That's right.
Q And so what I attempted to do, and asked someone to do for me, was let's just assume there's no curve, it's just a flat line. Go to the same Bloomberg calculator, what number do you get. That's what I've attempted to do. There's Bloomberg screenshots attached to it. Generally, if we'd done that, and I don't expect you to verify this for me, but

as an approach, if one had gone to the Bloomberg calculator and said, we're going to use flat spreads, it should give you a result, correct?

A Yes.

Q And it'll give you a lower number than the one you've come up with, correct?

A That is correct.

Q Since you're going to be back tomorrow, probably, if you want to point out to me any mistakes we've made in running the Bloomberg, you can.

THE COURT: You're not entitled to give the witness homework, Mr. Tambe.

MR. TAMBE: It's in fairness to the witness, Your Honor.

Q So roughly it drops your value by about 6 million, correct?

A That's what this page shows.

Q Okay. And so if you were to extrapolate that using the same heuristic approach, it would drop your Merrill floor from 89 down by I guess $18 million?

A If you say so, I --

Q It's three --

A -- haven't done the calculation.

Q It's three to one, right?

A That's correct, yes.

Q Okay. Okay. So two other issues with Case 1, right? So we can go up, please. The Case 1 starting point are October 1, October 2 offers from Merrill, correct?
A Yes.
Q And stuff had happened between September 15th and October 1, correct?
A Invariably, yes.
Q Well, some pretty nasty stuff had happened between September 15th and October 1, right?
A And -- bad and good stuff.
Q So --
A We saw a sharp decline, as we saw yesterday, in preferred prices early in the week of September 15th and then a recovery. But yes, good and bad stuff had happened.
Q And you made no effort to walk back the Merrill offers to the September 15th environment; didn't you, sir?
A I certainly made an effort. I concluded that that was not a reasonable exercise to perform.
Q So you don't express an -- a walk back opinion or walk back results in your report; do you, sir?
A No, I addressed it in my rebuttal report instead.
Q In contrast to sort of the heuristic approach of simply applying, mathematically, the Merrill results to the rest of the population, you offered that as a calculation, but you didn't believe that that was a proper calculation to do; is

that right?
A I'm sorry, can you ask the question again?
Q The exercise we just went through, to go from 29.6 million to 89 million --
A Yes?
Q -- you've offered up that calculation --
A Yes.
Q -- but you have reservations about that calculation; do you not, sir?
A I do.
Q Okay. Because there's different populations of names, correct?
A Correct.
Q In fact, the Merrill Lynch offers generally have -- I think they're all non-U.S. names; is that right?
A That is correct.
Q Whereas the population of PCDS had a variety of non-U.S. and U.S. names, correct?
A That is correct.
Q And some of those U.S. names, their preferred securities were trading at fairly high valuations, correct?
A Yes. Wachovia was trading very well, others were trading very poorly, like Citi.
Q I think you meant to say Wells Fargo was trading very well?

A I'm sorry, you're correct. I stand corrected. It was Wells Fargo, yes. Wachovia was not trading well. Yes, thank you.

Q And CBA, Commonwealth Bank of Australia, that was trading pretty well?

A CBA and A&Z were both trading well. CBA and A&Z were other trading -- A&Z.

Q And I think HVD was another non-U.S. name, not in the Merrill population but in the trade population, correct?

A That's correct.

Q And that was trading pretty well, correct?

A It was.

Q All right. And so you could make the case that it's not just a mathematical heurithmatic calculation, but you could do a weighted calculation to use the Merrill results to arrive at a more accurate population result, correct?

A I'm not -- I haven't thought about how you would do the weighting.

Q So you haven't thought about it and you haven't done it?

A No.

Q Okay.

A No, that's why I presented what I call the heuristic approach.

Q On average, have you done any analysis to see, on

average, how did the Merrill Lynch names compare to the non-Merrill Lynch names?
A Yes, I have, at one point, but it was a long time ago at this stage and I don't recall any details about it. My general recollection was I thought that the credit quality of the non-Merrill names was no better than that of Merrill names, conceivably worse. But I have no details I could give you on that at this point. And I'd be happy to see data to support or contradict that belief.
Q You can't give me homework either. All right. So now let's go to PCDS Case 2. So let's -- you start off with I think Page 39 of your demonstrative -- or Page 38 of your demonstrative. On Page 38 and 39, again, you refer to some publications. Do you see that?
A Yes.
Q Again, these publications are talking about general approaches to modeling and valuation, correct?
A They are talking about general approaches, yes.
Q Not telling you exactly how to construct the curves you constructed, correct?
A No.
Q So now your curve construction in Case 2 was more involved than in Case 1, correct?
A Yes.
Q Okay. So let's go to 40, just to list out all the

steps you took. All right. So you got no PCDS offer that you can observe in the market, so you start with the price of an underlying preferred security and you build your way up to finally get to a valuation, correct?
A Correct.
Q I have a question for you, is that the order in which you did your math?
A The -- effectively. The second and third steps have to be simultaneously. That is to say, the option adjusted preferred stock spread curve depends upon the value of the embedded call option. The two have to be calculated at the same moment.
Q So you were calculating two variables at the same time?
A Correct. I'm iterating until those two variable together result in the price of the preferred stock.
Q So and you used the word iteration.
A Yes.
Q You're running, what thousands and thousands of calculations?
A We're running thousands of simulations, which then iterate in order to find the price of the preferred stock, yes.
Q Okay. So two and three are not really distinct, they're run simultaneously, correct?
A They're two distinct concepts, so I needed to lay them

out as two distinct concepts. But they have to be computed simultaneously.

Q So that's a mathematical simulation that you run?

A Yes.

Q How about -- so let's assume two and three are really the same step or at the same time. How about just the order of operations, is the order of operations accurately set forth on that slide?

A I think so. Adjusting for hedging involves changing the price of the preferred stock and rerunning two and three. I could switch the adjustment for the CDS bond basis and put it at five instead of four, I suppose. But what happens here, let me explain it, is I find a right price --

Q Can you just focus on my question?

A Sorry, sir.

Q The question was, order of operation. And that's a phrase you know, right? Order of operations?

A Indeed.

Q It matters in math, correct?

A Indeed.

Q So four plus -- no, let's do it on a piece of paper. Give me a blank piece of paper. I just want to make sure this point gets through. We're both talking about the same order of operation, but not different ones. Okay? Let me start writing.

A Sure.
Q All right. If I do four plus two plus eight, it doesn't matter what the order of operation is, correct?
A Correct.
Q You're going to get to the same result, right?
A Correct.
Q Multiple by eight, now the order of operations matters, correct?
A And there is a convention in mathematics, My Dear Aunt Sally.
COURT REPORTER: (Indiscernible)?
A My Dear Aunt Sally.
Q Multiplication, division --
A Addition --
Q Actually, (indiscernible) is exact.
A -- subtraction. Yes.
THE COURT: What are you two talking about?
MR. TAMBE: We're just doing the build up to get to the point.
Q So the point is, order of operations matters in math?
A Correct.
Q Okay. Going back to your curve construction, order of operations matters in what math you're doing to construct your curve, correct?
A I'm not sure that I can accept that until you can point

to me to what it is in particular you have in mind.
Q Okay. When you say adjust for hedging --
A Yes?
Q -- right, you list that as step five?
A Correct.
Q And you say you adjust for hedging after you have found the option adjusted preferred stock spread curve, correct?
A Yes.
Q I thought in response to an answer just a few minutes ago you said to adjust for hedging you have to go back and rerun two and three, correct?
A That is correct. Yes.
Q Okay. That's what I meant by order of operations, this is not linear, you go one, two, three, four, five, back to two and three, to get down to six?
A No. It is linear for Scenario 1.
Q But Scenario 1 you're making no adjustments for hedging, sir.
A Indeed. Yes, exactly.
Q You're assuming the issue away?
A Indeed. So and then put Scenarios 2, 3 and 4, or Scenario 2 and -- (indiscernible) estimate scenario, I then have to introduce hedging, which then causes me to re-compute steps two and three.
Q So in fact when you did the math, anything other than

your base case, your Scenario 1, you did one, two, three, four, five, went back to two and three to get the six?
A Correct. Yes.
Q Okay. So that's not what's shown on this Exhibit 40, correct?
A Well, I certainly did not intend it to be misleading, but I'm happy to make the clarification.
Q It's not a question of misleading, sir, it's a question of the complexity of your calculations. And you've got words on the Slide 40 that suggest those were the steps you followed, in that order. In fact, you describe them in the subsequent pages.
A Yes.
Q In reality what you did was you did step one, you found a price. In steps two and three you ran thousands of simultaneous calculations.
A I mean of the order of a thousand, yes. Of the order of a thousand, but then we have to iterate in order to find the price. Yes.
Q Once you got back you made an adjustment for CDS bond basis, correct?
A Yes.
Q And then other than your base case scenario, you then made an adjustment for hedging?
A Correct.

Q And then you went back and ran two and three again?
A Correct.
Q Okay. And then you created your PCDS spread curve that you would use to price the positions, correct?
A Absolutely. That's accurate. I appreciate the clarification. Yes.
Q And again, same rule as in Case 1, the higher your curve in the prompt years, the first five years, the higher the valuation of the PCDS that you come up with, correct?
A Correct.
Q Why don't we stay on this? When you say find the right price, the higher the price the lower your valuation, correct?
A Correct.
Q All other things being equal?
A Yes.
Q Okay. Number four, adjusting for bond -- CDS bond basis --
A Yes.
Q -- that was a negative eight basis point adjustment that you made?
A Yes.
Q So again, the more negative that basis, the lower your valuation, correct?
A Correct.

Q So instead of adjusting by negative eight basis points, if you'd adjusted, for example, by negative 20 basis points, the curves would be shifted down, correct?
A They would go down by about -- yes, the values by about $600,000. Yes.
Q And if you went down to minus a hundred basis points, they'd go down by a lot more, correct?
A Yes.
Q And that's not a linear function. There's a lot of complex math here, correct?
A It's -- no, I mean, the CDS bond basis is you're just going to adjust the CDS spread curve that goes into the Bloomberg calculator you showed earlier, it's not precisely linear, but it's not radically different from linear for those sizes of movements.
Q But you don't stop after you adjust for CDS bond basis, because the next thing you do, in everything except for your base case, you then make a further adjustment for hedging, correct?
A Yes.
Q And that increases the value of the positions --
A Correct.
Q -- generally, correct?
A Yeah.
Q And then you go back and run the curves again, correct?

A Correct.
Q Okay. None of the materials you cite in your report or on the demonstratives actually spell out doing a PCDS valuation (indiscernible)1:34:49; do they, sir?
A Indeed. The PCDS market didn't really exist, so I didn't expect --
COURT REPORTER: I'm sorry/
A The PCDS market didn't really exist, I would not have expected to find significant literature on PCDS valuations. I looked for it and I did not find any such literature, so I had to develop a reasonable approach.
Q And it's, as far as you know, a unique approach, correct?
A Insofar as that nobody else has done it, it is by definition a unique approach.
Q And if someone else were to start with the basic building blocks, finding the right price, they might disagree with you what the right price was, correct?
A Well, I'm quoting Exchange traded prices on securities that traded at the time, so I would be a little surprised, but I'd be happy to have the conversation.
Q Well, someone else might say, I see the Exchange traded prices, but I also see the Bloomberg prices, I'm going to use the Bloomberg prices, correct?
A They might say that. I would disagree that that would

be a reasonable approach.
Q But every single day hundreds of thousands of bankers around the world turn on their dealer broker terminals and use Bloomberg data, correct?
A Yes, they do. But I can't speak to how much attention they paid to the prices of particular preferred stock issue on September 15th, 2008.
Q And in fact, unlike spending a year and a half, 18 months on a complicated expert engagement, they make split second decisions for billions of dollars, off of what they see on their Bloomberg terminals, correct?
A I certainly have the experience that people look at the prices that are shown on Bloomberg terminals with a certain degree of skepticism. It's not an automatically accepted price.
Q When you're making split second trading decisions, sir, you're not building models and iterating thousands and thousands of calculations and then going back and adjusting for hedging, correct, sir?
A It depends on what technology you have available to you. If I'd been trading these instructions at Goldman Sachs at this time, no. Though I was -- not that I was at that company at this time. I would certainly have wanted to have a fulsome set of analytics available to me at a push button. Having said that, your point, I thought, was about

the accuracy of Bloomberg prices. It's a simple matter to conclude the price is potentially not a representative price for where I can transact in the marketplace. That can be done in a split second.
Q Sir, not my question. My question was some other trader or valuator might have a different view of what the right price is, than you do, correct?
A I can hardly dispute it, but without being misleading I think that finding an actual transaction price is quite solid evidence.
Q How about broker runs, broker runs on preferred security prices the week of September 15th, 2008? Someone would rely on those, couldn't they, sir?
A Potentially, yes.
Q And those prices could be different than what you call the right price, correct?
A They could -- you might well be able to find other securities on those broker runs. Again, the issue here, just to be clear, in finding the right price, is you have both an accurate price at which you can transaction, you also need to find the price of the cheapest security within the deliverable basket. So you can deliver any one of a number of securities into a PCDS contract. If you can find a security of a higher price, that doesn't matter, you need to try to find a security with the widest spread, the

largest implied losses, in order to calculate this contract.

Now it is possible that somebody could find security prices that were lower than mine. It's also possible they could find security prices that were higher than mine. I they found prices that were higher, it wouldn't be relevant. If they had found prices that were lower, it would be relevant.

Q So, I just want to understand your criteria, because I thought your criteria for picking the right price was whether it was Exchanged traded or not, not whether it was the cheapest to deliver.

A What I've done in this exercise is I've found exchanged traded prices. I have been unable to determine accurately what the cheap -- the price would be at the cheapest to deliver security, because I don't have access to enough transaction prices. It's possible that if I had access to more prices that actually transacted, I would find some that were a lower, or that implied greater losses.

Q So again, just going back on my point.

A Yes.

Q Someone else might have a completely different view of what the right price is, correct?

A They might have a view that the right price was lower, yes.

Q The point is very simple, sir. You go through all

these six steps --
A Yeah.
Q -- there's lots and lots of calculations and assumptions behind those steps. Someone else working with the same building blocks could come up with a very, very different value, correct, sir?
A Well, indeed. And to take your point --
Q You've answered the question. Thank you. Let's go to CX-2108. Are you familiar with this document, sir?
A It looks familiar, but you could perhaps refresh my memory.
Q Well, I'm not sure how I do that without you just sort of looking at the document. I put it before you. I know you've seen it, but you've got to tell us whether you remember seeing it.
A Could you --
THE COURT: If you want to drive around the document, just tell Mr. Tambe, okay?
A Yes. Could we please scroll down on this document? Thank you. And scroll up, please? Very good. Now could you please -- let's look at some of these other tabs to try and refresh my memory, please? Okay. Okay. Can we start in the first tab, please, the disclaimer? Okay. And response to? Thank you. Lehman Position's Master. Thank you. Market Responsible. Thank you. The next tab? Thank you.

Arthur. Can we scroll down on this tab, please? Very good. We can stop there. Thank you. Could we just go to the very top of Arthur's tab, please? Okay. And we can go to the next tab, please? And the next one? And the next one? And the next one? And the next one? And the next one? And the next one? And the next one? And the next one? And the next one? And the next one? Very good.

Let's go to the right on the tabs, please? Can we go to the QVT data, please? Is that available to me? All right. And the Trade Details tab, please? Hmm. What else is to the right? Anything else to the right? And any other tabs to the right? Can we see the Adjusted Claim, please? All right.

Very good. We can go back to the tab you have. This appears to be the data supporting the QVT claim. As I sit here, I don't recall the specifics of this data sheet, but I've -- I have no reason to believe I haven't reviewed it. I've reviewed very many data sheets.

Q Did you rely on the data in the PCDS data tab in forming your opinions, sir?

A No.

Q Okay. Thank you. Let's go to your demonstrative, Page 41. So in your analysis, step one was finding the right price, correct?

A Yes.

Q And what you explained yesterday was the -- what you defined as the right price was information you got on Exchange traded preferred securities, correct?
A For 8 of the 13 names, that's correct, yes.
Q And the point you made was that the Bloomberg, the BGN data lagged behind other data, correct?
A That's right.
Q Different problem than the Markit problems you described to the Court yesterday, correct?
A The Markit problems related to PCDS data, we're here talking about the data for the underlying preferred stock prices. These are different issues, yes.
Q And you would agree with me that the BGN data is data compiled by Bloomberg to a number of different contributors, correct?
A Bloomberg tends not to reveal how they do this. They say it's proprietary. A standard pricing source would use data from a variety of dealers and use some algorithm to distill that data into a signal data point. Therefore, it's reasonable to presume that's what Bloomberg does, but they don't tell us.
Q And nonetheless, even though Bloomberg doesn't tell you what their secret sauce is, you, when you were working at a bank, and hundreds of thousands of other bankers paid lots and lots of money to Bloomberg to get their data, correct?

A Well, I -- we -- and we still pay lots of money to Bloomberg, but mainly to use their analytics rather than their data.
Q Okay. So you think --
A It data is helpful in some cases. Their data is helpful in some cases, they have very good indicative data in the corporate bond universe, for example. They have quite a lot of good pricing data. But the quality of data varies from sector to sector.
Q Other than lagging behind, you identified for the Court no other issue with the BGN data on preferred securities, correct?
A No. And indeed I've used pricing service data for 5 of the 13 securities. As I say, it is difficult to be certain what the price of the cheapest to deliver preferred was on that date.
Q We spoke early on this afternoon about what might cause prices of preferred securities to move. Do you remember that?
A Yes, I do.
Q And so the Exchange traded prices that you're reflecting on 41, those are the preferred securities that are traded on exchanges in $25 par amounts, correct?
A That is correct.
Q That's different from the institutional market, which

is $100 par amount, correct?
A That's correct.
Q So you might have institutions trading on Exchanges, but you also have a lot of retail investors trading on Exchanges, correct?
A That's correct.
Q You made no effort, as you looked at those prices, and decided the Exchange prices were the right prices to account for differences in investor sentiment; did you, sir?
A I don't know of any way of doing that. But let me speak to the point, because it is a point --
Q Answer the question. You didn't do it.
A It's a point that was -- I considered and concluded -- I had two conclusions. One is I didn't see a strong method of making such an adjustment. And secondly, I concluded that any such adjustment would have increased the value -- my valuation. And so I did not pursue it for that reason.
Q Let's just be clear. The line you have there on Page 41, if you had used the data points on the BGN line, the higher price, your valuation would have been lower, correct?
A Again, it's important to use the cheapest to deliver security. So whether you're using an Exchange traded price or a pricing service price, you're trying -- you -- the proper analysis is to find the price of the cheapest to deliver security. It doesn't matter whether the pricing

service price is higher or lower. If the pricing service price were lower than that would be a better choice. If it were higher, then the Exchange traded security would be a better choice.

Q Just to be clear. What you told the Court yesterday is you picked the Exchange traded prices because they were traded on an exchange and BGN lacked, and that's the only basis you gave when you testified yesterday; is that right, sir?

A Well, I mean that is correct. That is correct. And --

Q Let's move on then. Let's go to Slide 43.

A -- I make the point in my report in chief as well.

Q You make lots of points in your report in chief.

Let's go to 43. All right. So now, let's do some curve construction the way we did in Case 1.

THE COURT: But before you move on, about two questions ago, in response to one of Mr. Tambe's questions, you indicated that you didn't do a particular variation on your methodology, and you observed that that would have resulted in a higher price.

A A higher claim. Yes --

THE COURT: A higher claim?

A -- a higher valuation. Yes.

THE COURT: Yes. So what?

A I want to --

THE COURT: Well, why did the fact that had you done it in that iteration it would have results in a higher claim, why was that a reason for not doing that as part of your methodology?

A I adopted the stance, throughout my construction, Your Honor, of when I had to make a decision about an assumption or an approach, to try, if I had to err, to err on the side of conservatism.

THE COURT: Thank you.

Q All right. So we're going to talk about case construction under Case 2 now. And just to reset the record let's --

A Yes, sir.

Q -- go back to how you did it on Case 1, how you did it differently for Case 2. So put back up, just for reference, the document we looked at earlier this afternoon.

A Yes.

Q Right? Which is 5987-A and there, when you started with your clean sheet of paper, to draw a curve you had a point, you had a offer from Merrill Lynch for 7 1/2 years out, correct?

A That's right.

Q Okay.

A Thank you. Ah, okay.

Q Now I've handed you, Dr. Niculescu, an exhibit marked

5988. And that's not terribly informative, because that's completely blank, right? And that's how you began Case 2, correct? You didn't have a data point to even begin the curve construction, correct?
A Well, I had the price of the relevant preferred stock security.
Q Yeah, but your left axis isn't a price axis; is it, sir?
A No.
Q Right. So you're trying to solve for spread, and you've got a blank sheet of paper, right?
A I had a little bit more information than a blank sheet of paper.
Q So let's start building in what information you had.
A Yes.
Q You know the name of the issuer, in this case it's going to be Credit Agricole, right?
A Yes, sir.
Q And you're going to know Credit Agricole's senior CDS spread, correct?
A Yes.
Q And so you can go out to your five-year point and pin that flat line that you discussed earlier, correct?
A That is correct.
Q That's where you start, right?

A That's where I start.
Q Okay. Let's do that. So again, not to scale, I'm just going to draw a block. So you start by drawing a line, right? At -- starting at Year 5, flat all the way through, correct?
A That's correct.
Q So -- and that's an assumption you made, correct?
A Yes.
Q You still don't have anything else to anchor this line. You're now trying to fill in Year 0 through 5, correct?
A That's correct, yes.
Q And the curve you draw, unlike Case 1, doesn't have to go to any particular point, correct?
A It has to result in a set of discounted cash flows that equal the price.
Q So it can have pretty much any shape, as long as you solve that to the price that you're covering, correct?
A Well, I tell it what shape it has to have. I use the same process, that you described so well, in Method 1.
Q Right, you tell the curve what it should look like, correct?
A I tell the curve that it should have a peak the first two years, that the incremental hazard rate should drop by half for the next three years, and then it should revert to its long term level.

Q Correct. And again, so you tell the curve what it's going to look like and -- something like this --
A Something --
Q -- would you say?
A -- something like that, yes.
Q Right. And with those rules you again run thousands of calculations until you can match up that spread to the price that you call the right price, correct?
A To the observable price of the preferred stock security and market, yes.
Q Speaking about curves, right, the yield curve for U.S. Treasuries --
A yes?
Q -- that's a yield curve that's based on transactions that occur in the market with investors buying and selling securities of various maturities, correct?
A Yes.
Q So there it's not someone like you telling the curve what it should be, it's investors making decisions and saying, here's how much I want to be paid to lend the government money for six months, for a year, for five years, et cetera, correct?
A Correct.
Q Right. That's not the process you used, you told the curve what it should look like, right?

A Yes. Anybody doing this analysis has to make an assumption of the shape of that curve. In order to do a valuation you have to make that assumption. I made an assumption.

Q Well, again the assumption you made has the spreads a lot higher, in Years 1 and 2, high in Years 3 to 5 and then pinned down at 1.1 of the senior spread for the rest of the maturity, correct?

A Correct.

Q And someone else looking at building a curve might have a very differently shaped curve which is a lot lower than your curve the first few years, correct?

A People can make different assumptions. I believe -- I'm of the opinion that this is one of the more reasonable assumptions one could make.

Q Right. And in fact you have not looked at any other opinions about constructing PCDS curves in any of the literature you've read, correct?

A I didn't see any discussion of PCDS curve construction in and about September 15th of 2008.

Q Well, or since, correct?

A Or since.

Q And again, to complete the thought. So you start out by telling the curve it should look like Exhibit 5988 and then you convert that into the curve you showed the Court in

Page 43 of your demonstrative, correct?
A Yes. But in order not to be misleading, but the positions of those first two lines are determined by the price of the security and the embedded call option of the security.
Q Well, not quite, right? The positions of those first two lines you also determine what you do with the third line, and where you place the third line, correct?
A Correct. Yes.
Q Okay. So because if you would assumed higher risk from Years 5 on out, the first two lines would be in a different place, correct?
A That is correct. Yes.
Q And the first two lines would be in a different place if you said, this is going to be a short-lived crisis, at the end of Year 1 it's going to fall down and it's going to go something like this for the remainder of time, correct?
A So there you've made two different assumptions.
Q Sure.
A One is that it stays higher in the future. If you kept the old assumption that it was lower in the future, then the spread in the first year would be much, much higher.
Q Okay. Again, assumptions that people could make as they were constructing these curves, correct?
A Correct. Yes.

Q And you had no empirical data to say it's got to be this set of instructions to draw my curve, correct?
A I don't believe such empirical data exists but I attempted to make a reasonable set of assumptions.
Q Right. And we already discussed this, that this approach, where you start with a blank sheet of paper, and solve back for a curve, without any data points on PCDS, this is not an analysis you -- excuse me, this is not an analysis you tried to replicate through your Case 1 names, correct?
A Correct.
Q Okay. Because that would be another way of testing how good you were at constructing a curve on a blank sheet of paper, correct?
A Not necessarily. Merrill Lynch was axed in Case 1, so I have no initial comfort with the thought that their axed PCDS positions would match any particular valuation or would cast doubt or support on any particular calculation.
Q Right. But you didn't even change?
A That's correct.
Q Okay. All right. This question came up yesterday, right, about Merrill Lynch being axed, right?
A Yes.
Q And what you mean by that is, they have sold protection to Lehman?

A Yes.

Q Right? And Lehman had gone away?

A Yes.

Q And you're assuming that they wanted to replace that exposure with others in the market, correct?

A I think it is likely, yes.

Q So you're assuming Merrill Lynch is sitting in the middle, it's got people selling protection to Merrill Lynch, it has sold protection to Lehman, the Lehman leg has gone away and so Merrill is sitting looking at protection being sold to Merrill by a bunch of third parties?

A Potentially CDOs or -- yes.

Q Right. And Merrill Lynch is obligated, because in that position it's the protection buyer --

A Yes.

Q -- to make fixed payments to those third parties for the remaining life of those deals, correct?

A Correct.

Q As we discussed at the very beginning, that could be a losing proposition for Merrill if a deferral event never occurs, correct?

A That is correct.

Q And that's the risk that Merrill Lynch is trying to offset by offering protection on those names to the market, correct?

A Yes.
Q Okay.
A I have said yes, but I fear again I've been misleading. While the simple answer is accurate, it's also the case that there was a market valuation of that PCDS at that moment, so their potential loss is not just the loss of the premium, it's the loss of that market valuation.
Q But again, the risk that Merrill Lynch is trying to reduce, by offering protection on these PCDS is the risk that it'll make these fixed payments for a number of years without receiving any protection payment in return, correct?
A That is one risk. Merrill Lynch, most likely, had these positions mark to market and considered there was a market value to the positions.
Q You don't know --
A That market value reflects the underlying premium and a risk premium.
Q You don't know what Merrill Lynch was thinking, at all, when it made that offer to The Street, other than it made the offer, correct?
A Correct. However, it would be highly unusual for a dealer not to mark to market its positions.
Q I get that. But you looked at the exhibit with me this morning. The blotter.
A Yes.

Q There were lots of other similar positions where Merrill Lynch had sole protection to Lehman, which weren't part of the offer.
A That may very well be. I have nothing to add about that.
Q All right. Let's... So, in your steps so far you have picked the right price, then you've drawn the curve by telling the curve what it should look like, correct/
A Correct.
Q And now you're making some other adjustments, correct?
A Yes.
Q We're onto the next step. And so the next adjustment you make is you say, all right, I'm going to account for the CDS bond basis differential, correct?
A Correct. Again, just to be fulsome, you mentioned -- I mentioned the option adjusted spread and I'm happy to go past that if you wish, sir.
Q No, no, you're absolutely right. Let's go back and do that in sequence. So that's on Page 42. Order of operations matters, right?
A Not necessarily. They tend to be commutative. So...
Q So, this is what you're referring to -- you're trying to value the indebted call option, correct?
A Yes.
Q And you're trying to remove a feature from the

underlying -- or account for a feature of the underlying preferred equity, correct?
A Correct.
Q We discussed this afternoon, early this afternoon, that one of the adjustments you make when you're looking at an underlying on a derivative is you want to account for maturity differences, right?
A Yes.
Q Is that what you're doing here?
A No. This is a little bit beyond that. It includes that and it's a little beyond that.
Q So, you are accounting for maturity differences by doing this calculating and then you're making some other adjustments, is that right?
A The additional adjustment is to value the call option that the issuer holds that may well be exercised long after the maturity of the PCDS contract but that nonetheless affects the value of the preferred stock itself.
Q I just want to be clear on this. Your calculation includes a component of your calculation is immaturity adjustment, correct?
A Indeed. The cash... Let me try to be clear. The cash flows that I'm valuing in the PCDS only run out to the maturity of the PCDS.
Q Whereas the price you're looking at, which is the

underlying security price, that's for a security that could well be perpetual, correct?

A That is correct, yes.

Q And what you're trying to remove from that price or after that price -- what you're trying to account for in the price is that optionality?

A The call optionality, indeed, yes.

Q Because if you didn't do that, your theory would be wrong?

A Yes, the theory would be in appropriate if I didn't adjust for the call option.

Q Talk to me now. (indiscernible) bond basis adjustment. Now we're on Page 44 and this is the step where you make a deduction of 8 basis points for the bond basis differential. And what I want to ask you about is your source for that, and I have to find that place in my binder. So, looking at Slide 44, it doesn't tell us exactly where you got that from, but there is an exhibit and it's in the black binder and we'll pull it up on the screen. So, Tab 24 on the black binder, which is X1526. I believe, and we've discussed this before -- if you go to Page 47 of that exhibit...it's...

THE COURT: Numbered or Bates?

MR. TAMBE: So, the Bates Numbers is 6078 are the last four digits.

Q The chart you have in your demonstrative is based on,

it looks like, the bottom left chart on that page. Is that right?

A That is correct, yes. It's the page entitled CDS Bond Basis, sir?

Q Yes. And that's the document you relied on to come up with the eight basis point adjustment, correct?

A That is correct.

Q Okay. Now, those lines, those are lines drawn by J.P. Morgan, correct?

A Yes.

Q And they're drawn the basis of some index, correct?

A That's their index, yes.

Q And that's not an index that you examined the constituent parts of when you put your report together, correct?

A They did not make that available to me, no.

Q And you didn't in the course of your work call up JPM and say, can you please tell me what's under these lines, because they're an important part of a calculation on submitting to the Bankruptcy Court?

A Well, as a matter of fact, I'm not sure whether my team did or didn't. We may have but we didn't -- whether we did or not, we certainly did get it.

Q Not a question you didn't get it -- you don't even know if you asked for it?

A As I sit here today, I can’t tell you whether my team asked for it or not.
Q So, you tried to find, I guess, on both lines what those lines tell you about September 15, 2008, correct?
A Yes.
Q And you didn’t have the underlying data, correct?
A That is correct. I only have the picture here.
Q Did you hold up a ruler to this diagram to figure out where September 15th is, sir?
A Yes, I did. In fact, I put red lines over it on a computer and looked at the gridlines, and the gridlines came out to September 15th, being that one point that you see there -- the 8 basis point --
Q I’m just trying to picture this. When you said you put gridlines on your computer...
A Yeah?
Q ...I’m looking at a PDF document, I guess.
A Yeah.
Q You drew lines on it?
A We inserted that into an application where you can draw gridlines over it, and yes, that’s what we did.
Q So you drew lines on it and how thick were the lines?
A Not particularly thick.
Q Well, if the lines are kind of thick, you might go from September 15th to September 16th and not even know it,

right?
A Well, you appear to have a date here of September 17th on the report, and the last point would be September 17th, and you can see individual movements day by day. So I think that the conclusion that the September 15th point is the eight basis points -- point was substantiated by those number of days.
Q I understand what you did. Can I give you a ruler so you can show what you did?
A Sure. Sure.
Q So, I've got a yardstick.
A Very good.
Q So, can you just show us what you did to get to the eight basis point assumptions, please?
A Sure. What we did was to simply draw gridlines across this, matching up to each one of these date lines. So, for example, this data point here matches this point, matches the 12th. And each one of these data points is one day. We count them out. But this is September 12th, this is September 15th, this is September 16th, and this is September 17th, which was the publication date.
THE COURT: When you're pointing to a data point, what are you pointing to?
DR. NICULESCU: So, I'm pointing to this black line here.

THE COURT: Yes?

DR. NICULESCU: And you'll see that there's a little notch here --

THE COURT: I see that. But then you're saying this is --

DR. NICULESCU: And that refers to --

THE COURT: I understand that but then --

DR. NICULESCU: -- which refers to this date right here. Thereby this is the 15th, this is the 16th, and this is the 17th.

THE COURT: How do you know that that's the 15th?

DR. NICULESCU: Well, because this is Friday and this is (indiscernible). There's no data on the 13th and 14th (indiscernible). And if you count back to the number of (indiscernible) they match up. Each time there's a little jiggle (indiscernible) day.

THE COURT: I'm just not following the little jiggles. I don't... There are no... I see the curve but I don't see any points. I don't... For example, if you look at August 29th, right? How do you know which day is which?

DR. NICULESCU: This... (indiscernible) I think that this is the (indiscernible) point.

THE COURT: Right.

DR. NICULESCU: And if you look at September 12th, it's right down here (indiscernible) --

THE COURT: Right. Right, but there's no -- but you're moving across the access arbitrarily. There's nothing that tells you where -- there are no data points on there. There are no points.

DR. NICULESCU: So, I know that this is a different data point than this once -- we just moved (indiscernible) instead.

THE COURT: Right. But how do you know...? For example, in the long decline after August 29th to September --

DR. NICULESCU: Right. I can't distinguish what (indiscernible) precisely.

THE COURT: Yes, that's my point.

DR. NICULESCU: I can distinguish these points here.

THE COURT: Oh, I understand. Right.

DR. NICULESCU: I can distinguish this point, this (indiscernible)...

THE COURT: Right.

DR. NICULESCU: Thereby this has to be (indiscernible) --

THE COURT: Because it's a weekend.

DR. NICULESCU: This has to be September 16th, and this has to be September 17th.

THE COURT: Okay, thank you.

DR. NICULESCU: (indiscernible)

THE COURT: Okay, I understand. Thank you.

DR. NICULESCU: You're welcome.

Q This adjustment that you make, the 8 basis point adjustment is one -- the negative 8 basis points. And it reduces your valuation, correct?

A That is correct, yes. By about $50,000 I think.

Q So at last -- right, but only $50,000.

A Correct.

Q In fact, if you had made an adjustment of 50 or 100 negative basis points, there would be a lot more than $50,000, correct?

A Yes. It would be of the order of 4 or 5 million. Yes, I mean, or 100...yeah.

THE COURT: I'm sorry. And how do you know that it's eight?

DR. NICULESCU: That is just by eyesight. That is just by drawing a line directly parallel --

THE COURT: Right.

DR. NICULESCU: (indiscernible) and (indiscernible) at this point (indiscernible) for example.

THE COURT: Okay, thank you.

Q The total number of hours spent by you and your team on this assignment as of January 30th I think is 6,415 hours, is that right?

A That’s what I’ve seen.
Q For a total cost of $5 million, correct?
A That’s what I’ve seen.
Q How much time do you spend drawing lines on this page?
A Not very many.
Q I would think not. Now, in this report --
A We have a lot of documents to review, sir.
Q If you get to 49, the next two pages down on this very same document where you drew lines --
A Yes, sir?
Q -- at the top of the page there there’s a section called High Grade Most Positive and Most Negative CDS Bond Basis. Do you see that?
A Yes.
Q And there’s individual names identified as most positive and most negative. Do you see that?
A I do.
Q And the last name there under 12, under Most Negative is Sun Trust Bank. Do you see that?
A Yes, I do.
Q And you recognize that as STI, correct?
A It’s one of the entities, yes.
Q And it’s one of the entities in the portfolio that you were asked to value, correct?
A Correct.

Q And for that entry, the basis is a negative 326 basis points, correct?
A That is correct.
Q Right. Okay, but you didn't use that data point, an actual number in your calculation, correct?
A No, I don't have it for the other names. And in any event, that's for September 17th.
Q Let's go back to 47. In fact, again, at the bottom of that (indiscernible). Again, that 8 basis point number that you're using which reduces your valuation, and that's the only number you use there, you don't even know what drives those lines; what are the underlying components, correct?
A As I say, they're not made available. No, that's correct.
Q One of the components is identified in the document and you don't use that, correct?
A That's correct.
Q And you didn't try to find the individual basis spreads for any of the other components, did you, sir?
A I don't think that we were able to find them for all of the other components. That's not data that we were able to determine.
MR. TAMBE: Maybe a short break right now?
THE COURT: Sure.
MR. TAMBE: I'm not sure what your timing looks

like.

THE COURT: No, that's fine. We can -- I think those folks will be assembling quiet, but we can take a break for maybe ten minutes.

MR. TAMBE: That's fine.

THE COURT: IS that enough time?

MR. TAMBE: Yeah, it's enough time. I'm not going to be done today.

THE COURT: No, I know you're not going to be done today. So we'll just go to a stopping -- we'll go to a reasonable stopping point on or around 4:30.

MR. TAMBE: And Mr. Tracey and I would just like to speak with you.

THE COURT: Sure. Do you want to do that now or do you want to do it after the break?

MR. TAMBE: I can do that now.

MR. TRACEY: Why don't we do it after the break? I just have to...

MR. TAMBE: Sorry.

(Break)

Q So, Dr. Niculescu, I want to go back to your curve construction methodology one more time.

A Yes.

Q And if we can go to the overhead, please? So this is Exhibit 597A. And you've described for the Court the

macroeconomic basis for your stepdown, correct?
A Yes.
Q And when I say macroeconomic, what I mean is those assumptions about the crisis will last a couple of years, then it will abate, and then it will disappear -- those are macro assumptions, correct?
A Macro financial system assumptions, yes.
Q Right. As distinguished from issuer-specific assumptions. What's Wells Fargo going to do for the next two years? What's Wells Fargo going to do years two through five? That's not the analysis you did, correct?
A No. That is correct, yes. Having said that, the curves are individual to each issuer.
Q I understand you created individual curves but your assumption was that the same macroeconomic financial assumptions about the severity and length of the crisis would apply equally to Wells Fargo as, say, a Wachovia, correct?
A Yes. Although given the differences in the names, Wells Fargo might well have had a much less inverted curve, for example. It varies by the issue where you have that data.
Q Or it may not have an inverted curve at all?
A That's possible. I don't recall.
Q Your general recollection is most of your curves were

inverted, correct?
A Yes, correct.
Q Because that's what you told the curves to look like?
A No. I told the long end to get fixed at a long debt curve plus a spread. And then I asked the algorithm to find the short spreads that resulted in a sort of discounted cash flows that equaled the price of the preferred stock.
Q You did more than that. You told the algorithm what rules to follow, you told the algorithm what that relationship would be between the first line and the second line, and then onto the fixed third line, correct?
A I didn't do more than that; I did precisely that in the way that you are describing.
Q It wasn't like you just said to the algorithm, please give me a curve; you fed inputs into the algorithm. It gave you the curve that you specified, correct?
A I don't have access to artificial intelligence. No, I do have to tell the algorithm how to do it.
Q So, it drew the curve you told it to draw?
A It drew the increments in the second -- the first two stages the way I asked it to -- the way I told it to draw those increments.
Q And the valuation turns on where you put those first two lines because that's the first five years, correct?
A Yes, that's correct.

Q Right.

THE COURT: Can I ask a question, Dr. Niculescu? Do you have in your work papers or otherwise what in my lay terms I would call sensitivity analyses? In other words, showing how to the extent that you varied each of your steps by a certain increment, how that would affect the outcome, similar to the way you've testified on certain other points of your analysis?

DR. NICULESCU: Yes, I've done various other drafts of the report. Varied assumptions.

THE COURT: I don't want to get into drafts of the report and violate any of the stipulations that the parties have in that regard. I'm simply asking the empirical question of whether you run sensitivity analyses to see, for example, if you used a different, you know -- if you used seven for the CDS bond differential, what that would do to the number that comes out of the model?

DR. NICULESCU: Yes, I did use different structures at various points before settling on this one. Those structures were in earlier drafts, but I did use different structures.

THE COURT: Okay.

MR. TAMBE: So, I think any testimony about structures that were in drafts and work papers for which we are not producing are stricken, Judge. We didn't have the

opportunity to review a sensitivity --

THE COURT: Well, I didn't ask about structures. I'm trying to ask a question about if instead of using eight you used seven -- very simplistic. Or if, as Mr. Tambe's been going with you, instead of using 1.1 you used 1.2 as of a certain date, if you ran those in all of your iterations?

DR. NICULESCU: I ran a number of iterations of that type, yes. I mean, in the case of the eight basis points, what would seven have been, what would 20 have been, what would 50 have been, for example? In the case of the shape of the curve, yes, I changed the shape of the curve at various points, experimentally. I changed recovery rates, I changed the long-term increments. I made a variety of tests like that.

The issue that I'm faced with is that those were developments that are in both sensitivity analyses and preparatory work that led up to this final product.

THE COURT: I understand.

Q Let's turn in your deck, Dr. Niculescu, to Page 46. Now, this is an analysis that you did of changes in the prices of preferred equity securities, correct?

A Yes. Not an analysis; I simply observed prices from the exchanges -- reported from the exchanges.

Q So, that's the next part of my question. The changes you're looking at are for exchange-traded preferred

securities, correct?
A   That's correct.
Q   And the only use -- use that you make of this analysis is to make the adjustment for hedging, correct?
A   It is an input to support my adjustment for hedging, yes.
Q   And so, whether you look at your min to max or your close to close, you're looking at a change in prices of the exchange-traded securities of somewhere between 9.7 and 13.1, on average, correct?
A   That's correct.
Q   And I think you then use that for hedging purposes to talk about your 10 percent scenario and your 15 percent scenario, correct?
A   That is an input. In response to a question from the Court yesterday, I tried to be clear that these numbers do not (indiscernible) my hedging sensitivities. They are an element that I considered in coming up with the adjustments to price that I use for hedging, which, in fact, has not just one component, but three components.
Q   And I think you said earlier this morning that just because the prices have changed in the underlying securities by 10 percent, doesn't mean the valuation or the PCDS has changed by 10 percent, correct?
A   That's correct. It may have changed by (indiscernible)

or more.
Q I think the range you gave was .4 to 1.5 or something like that?
A I think that's the range I gave. As I say, I can't vouch for that range. That's my best recollection, as I said...
Q So let's take a look at a demonstrative. 5986.
THE COURT: Thank you.
Q Sir, on Exhibit 5986 what we have calculated is the change in the PCDS valuation from QVT's books and records as of 9-12-2008, which is about 15 or $16 million, to their claim of $134 million, which, I think is about a seven-fold, 700 percent increase. Do you see that?
A I do.
Q And the calculation that you've come up with is 101 million to 129 million, which is anywhere between a 553 percent to a 734 percent change in valuation, correct?
A Actually, the top end of my range is 144 million, so it would be a larger number.
Q Even higher, right? As compared to the change in the prices that you calculated, which are in the range of 9.7 percent to 13.1 percent, correct?
A For these particular securities, that's correct, yes. I'm not opining on the 9-12 valuation.
Q Okay.

MR. TAMBE: I think we can stop here.

THE COURT: Okay, very good. So, how much longer do you think you have tomorrow?

MR. TAMBE: Very little. And I may be done -- I should go back (indiscernible).

THE COURT: Okay. And then we'll hear from Mr. Tracey.

MR. TRACEY: It'll be fairly limited.

THE COURT: Okay. Good. Thank you very much. Have a nice evening. Did we pick a start time for tomorrow?

MR. TAMBE: Any time that works for you.

THE COURT: 10 o'clock?

MR. TRACEY: 10 o'clock? That'd be good.

THE COURT: All right, 10 o'clock. All right, so, I'll let you tidy up and we'll let the other folks come in. Have a good evening, everyone.

(Whereupon these proceedings were concluded at 4:27:11 PM.)

C E R T I F I C A T I O N

I, Sonya Ledanski Hyde, certified that the foregoing transcript is a true and accurate record of the proceedings.

Sonya
Ledanski Hyde

Digitally signed by Sonya Ledanski Hyde
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Date: March 6, 2017